SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF LOS ANGELES, CALIFORNIA

BETTY BULLOCK, Plaintiff, vs. PHILIP MORRIS INC., a corporation; DUPAR'S RESTAURANT, a corporation; and DOES 1-100, inclusive, Defendants.

No. BC 249171
VOLUME I

Deposition of FRED S. McCHESNEY, Ph.D., at 777 South Figueroa Street, 45th Floor, Los Angeles, California, commencing at 10:13 a.m., Tuesday, May 14, 2002, before Lana L. Loper, RPR, CRR, CSR No. 9667, CCR No. 690.

PAGES 1 - 198

APPEARANCES OF COUNSEL:

FOR THE PLAINTIFF:

LAW OFFICES OF MICHAEL J. PIUZE
BY: MICHAEL J. PIUZE, ESQ.
11755 Wilshire Boulevard
Suite 1170
Los Angeles, California 90025
(310) 312-1102

FOR THE DEFENDANTS:

ARNOLD & PORTER
BY: THOMAS W. STOEVER, JR., ESQ.
MARK W. MESSENBAUGH, ESQ.
370 Seventeenth Street
Denver, Colorado 80202
(303) 863-2235

FRED S. McCHESNEY, Ph.D.,
the witness, having been administered an oath in accordance with CCP Section 2094, testified as follows:

EXAMINATION

BY MR. STOEVER:

Q Good morning, Mr. McChesney. My name is Tom Stoever. We met a moment ago. I am a lawyer with Arnold & Porter, representing Philip Morris in 10:13AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

this case.
You're here to testify as an expert. Is that correct?
A Yes, sir. 10:13AM
Q Have you ever given an expert deposition before?
A Yes.
Q Have you ever given a deposition on the subject of punitive damages before? 10:13AM
A It's possible the subject came up, but it would not have been -- the deposition would not have been specifically directed to that topic, no.
Q And do you recall whether the subject did, in fact, come up in any of your earlier expert depositions? 10:13AM 10:13AM

A I don't recall one way or the other.
Q When was the last time you gave a deposition?
A That would have been, I think, October of 2000. 10:13AM
Q Was that an expert deposition?
A Yes.
Q What was the nature of the case you were being deposed in? 10:14AM
A It was a case being brought by disgruntled shareholders against their auditors, or at least the person -- the lawyer for whom I was working was representing the auditors of the firm whose shareholders were bringing the action. 10:14AM
Q Okay. Have you ever testified before in a case involving a tobacco company?
A No, sir.
MR. STOEVER: I would like to have the court reporter mark as Exhibit 1 to your deposition a copy of the curriculum vitae Mr. Piuze gave us this morning. 10:14AM
(Defendants' Exhibit 1 was marked for identification and annexed hereto.) 10:14AM
BY MR. STOEVER:

Q And, Mr. McChesney, would you tell me -- would you please identify that document for the record?
A Yes. This is a copy of my resume. 10:14AM
Q And is this resume complete and up to date?
A It doesn't have a date on it, does it?
There may have been a couple of articles published since then. I note, for example, on 10:15AM page 4, there is a piece listed as forthcoming. That article is now out.
The one above it on page 4 -- I'm sorry. I'm not being very precise. The first two listed under "Articles and Book Chapters" shown as 10:15AM forthcoming are now out, and there may be one or two other things that have been published as well.
Q Of the articles that may have been published but are not listed on your resume, do they have anything to do with the subject of punitive damages? 10:15AM
A None whatsoever.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q I note from your resume you have a Ph.D. in economics, correct?
A That is correct. 10:16AM
Q Is there any particular field of economics 10:16AM

in which you have -- your research is specialized?
A I would say microeconomics principally as opposed to macroeconomics, industrial organization, law and economics. 10:16AM
Q When you say microeconomics as distinguished from macroeconomics, what is the distinction there?
A Macroeconomics essentially deals with, if you will, the big nationwide economic phenomena of 10:16AM
things like employment and gross national product and what have you.
Microeconomics tends to focus on smaller issues, smaller problems within the grander macroeconomy. 10:16AM
Q And you mentioned industrial organization. What is the study of industrial organization?
A It's the study of firms and markets, firm behavior, firm practices. Why do firms do the things they do? And why do they produce the way 10:17AM
they produce? Why do they write certain contracts?
It's the branch of economics that underlies antitrust law, for example.
Q In your study of industrial organization, have you ever done a study of the tobacco industry? 10:17AM
A No, sir. 10:17AM

Q Have you ever done a study of any tobacco company as part of your economic work?
A I have not.
Q I see you also have a degree in law, 10:17AM
correct?
A That is correct.
Q Are you licensed to practice law?
A I have been admitted into jurisdictions, yes. 10:17AM
Q Have you --
A I think my Florida membership is inactive.
Q Are you admitted in California?
A No.
Q What is your current position? 10:17AM
A I am affiliated -- or I am a tenured member of the faculty at Northwestern University. I am in both the law school and the Kellogg School of Management, which is the graduate business school.
Q How long have you been teaching there? 10:18AM
A Three years.
Q And that's three years at Northwestern at both the law school and Kellogg School?
A That is correct.
I should correct one thing. I have never 10:18AM
taught at Kellogg. I have an appointment in 10:18AM

Kellogg. I have an office at Kellogg, but all of my teaching for the past three years has been in the law school.
Q What classes do you teach at the law 10:18AM
school?
A Over the years, I've taught some

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

combination in any given year of -- certainly for the last five to ten years -- antitrust, corporate finance, statistics, the basic business law course. 10:18AM
I think that's it.
Q Do any of those courses have a component in which you discuss punitive damages?
A It's possible that in parts of the basic business law course, I have occasion to allude to 10:19AM punitive damages, a very slight amount, but I would say the dimensions would be fleeting and certainly are not an important component of the course.
Q Do you teach a remedies course at Northwestern? 10:19AM
A I do not.
Q Prior to your appointment at Northwestern, where were you teaching?
A I taught at Cornell.
Q How long were you teaching at Cornell? 10:19AM
A I was on the faculty for two years. 10:19AM

9

Q In the law school of Cornell?
A Also the law school.
Q What classes did you teach at Cornell?
A Same ones I just mentioned teaching at 10:19AM Northwest.
Q In the classes you taught at Cornell, did you have occasion to discuss punitive damages?
A Only in the same way I just described to you would be the case at Northwestern. 10:20AM
Q How long have you been teaching in law schools?
A Since 1983.
Q Since you've been teaching in law schools, have you ever taught a torts class? 10:20AM
A No.
Q Have you ever taught a class in remedies?
A I did a summer seminar for economic students at the University of Miami as part of their law and economics program. I think this would have 10:20AM been in the summer of 1984.
Q And in that course, did you have an occasion to discuss punitive damages?
A I would guess the subject must have come up. It certainly wasn't a principal focus of the 10:20AM course, but it's entirely possible indeed. I would 10:20AM

10

guess it must have come up at some point.
Q You don't remember it coming up in particular?
A I do not. I taught the course once as a 10:21AM seminar in the summer for economic students. I never did it again, so -- and that was, what, almost 20 years ago.
Q Right.
Other than the courses -- let me rephrase 10:21AM that.
Other than the fleeting discussions of punitive damages that you described to me, have you had any discussions in any of the courses that you've taught at any of the law schools where you 10:21AM have had an appointment where you have discussed the subject of punitive damages?
A No, I don't think so.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Do you have a specialty in any particular field of law?

A If you look at my resume, you'll see that most of my writings have been in the corporate and antitrust area. And as I mentioned to you before, those are two areas which I teach; those are the two principal areas in which I teach.

Q Are you an expert on the laws of

California?

A No, sir.

Q Are you an expert on product liability law?

A No, sir.

Q Are you an expert on the law of remedies?

A On the law of remedies, no.

Q You mentioned you teach a course in statistics.

A Yes.

Q Do you have an expertise -- I take it from that you have some expertise in statistics.

A Yes. Much of what I publish involves statistical work.

Q Are you going to offer any opinions in this case having to do with statistics?

A I haven't been asked to do anything along those lines, no.

Q So you haven't done any work along those lines?

A No, I have not.

Q Are you an expert in the field of polling or survey methodology?

A It's something I teach as part of my teaching and statistics. I'm not sure what "expert"

means in that context.

Q Are you going to offer any opinions in this case on the subject of polling or survey methodology?

A I have not been asked to do that, no.

Q Are you an expert in the field of medicine?

A No, sir.

Q Are you an expert in the field of philosophy?

A Well, Ph.D. is a doctor of philosophy, but I'm not -- philosophy of what?

Q The study of philosophy.

A Well, the only reason I'm hesitating there is somewhat a philosophical study of components I have done having to do with scientific method.

Q Describe that for me, please.

A Popperian philosophy.

Q Say that again.

A P-o-p-p-e-r-i-a-n philosophy, from Karl Popperian.

Q What is Popperian philosophy?

A Well, it has to do with whether or not we can specify falsifiable hypotheses; how we test them; the nature of the inferences we can make from

data and what have you. I get into this because it's an important element in statistics. That's

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

part of the underlying methodology of traditional statistics.

Popperian was, I believe, a philosopher. Therefore I don't want to tell you, no, I don't ever go anywhere near philosophy. But if you're talking about do I hold myself out as an expert in philosophy? Generally the answer would certainly be no. 10:24AM

Q So other than Popperian philosophy, you don't have an expertise in philosophy?

A Philosophy in science. I would say Popperian is just an example, if you will, of what I was talking about. 10:24AM

Q Are you an expert in the field of risk perception?

A No, sir.

Q Are you an expert in the fields of advertising or marketing? 10:24AM

A Well, I wrote my doctoral dissertation on lawyer advertising. When I was at the Federal Trade Commission, I was the number two person in the Bureau of Consumer Protection, which is the principal regulator of advertising in the United 10:25AM 10:25AM

States.

There's a division in the Bureau of Consumer Protection called the Division of Advertising Practices. I periodically consult with firms who have regulatory problems concerning their advertising. So depending on which aspect of advertising you are talking about in your question, I would say the answer is a definite maybe. 10:25AM

Q Let's try to pare that down a little bit then. 10:25AM

A Okay.

Q When were you with the Federal Trade Commission?

A 1981 to '83. 10:25AM

Q You were in the Consumer Protection Division?

A Called Bureau of Consumer Protection, BCP.

Q What was your job title there?

A I was the associate director for policy and evaluation. 10:26AM

Q And in that role, did your work include regulation of advertising?

A Yes, in the sense that I was responsible for reviewing the cases that the lawyers working in the division of advertising practices were working 10:26AM 10:26AM

on.

The bureau is divided in various divisions, and one of the divisions is the division of advertising practices. And those lawyers there would be the ones who, if you will, were the front-line regulators, but the cases all came to me for review and recommendation. 10:26AM

Q And when you say came to you for "review and recommendation," what was your role there? 10:26AM

A I mentioned before that I was sort of the number two guy in the bureau. The bureau director, the one to whom I reported, would be the one who would actually recommend to the commission formally

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

that the commission take action in a certain matter. 10:27AM
And the bureau director, who is today the chairman of the Federal Trade Commission -- back then he was a bureau director -- essentially delegated to me the review of all these cases, and so I would sit down with him after I had become very 10:27AM familiar with them. We would go over them, say, "This one looks like a winner"; "This doesn't look so hot."
And out of that meeting between him and me, we would come to the decision whether he would 10:27AM forward it on to the commission to have the 10:27AM

commission vote out a complaint or not to do anything further on the matter.
Q In your capacity as the deputy bureau chief, did you ever have occasion to review 10:27AM potential cases against the tobacco industry?
A I have to think about this for a minute because, as you probably know, the FTC is the organization that does the tar and nicotine content tests, and there may have been a case that we got 10:28AM involved with at the time that involved cigarette advertising. I think it had to do with a filter that was sort of a revolutionary design of a filter, and it was perceived that this filter -- at least perceived by some, that this filter allowed the 10:28AM manufacturer to sort of game/trick the cigarette smoking machines that the FTC used to get the measures of tar and nicotine content.
And I could draw you a little picture and show you what the filter looked like if you're 10:29AM interested in that, but that's the only one that I remember. And again, it grew out of this rather unusual role that the FTC has of smoking cigarettes and measuring their tar and nicotine.
Q Do you remember which cigarette company 10:29AM was designing that filter? 10:29AM

A Again, this is 20 years ago, and I didn't work very much on this case either. It was going on when I went down there, or the work on it had already begun, as I recall, so I was not terribly 10:29AM involved in it.
If I had to guess -- and it would really be a guess -- I would guess Lorillard, but I wouldn't make a large wager on that being correct. It's my best guess but don't bet the farm. 10:29AM
Q And you don't remember any details about the case other than what you have already told me?
A I think they were -- again, a lot of guess here -- but as I recall, they ultimately were forced to get rid of that filter or do something different 10:30AM so that what the FTC believed was the true amount of tar and nicotine was registered and, therefore, advertised.
Q Are you familiar with the FTC method for testing for tar and nicotine? 10:30AM
A No.
Q Are you -- let me rephrase that.
What's your understanding about the FTC's role in regulating cigarette advertising?
A Well, again, in this particular case, the 10:30AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

role stemmed from -- what they were doing stemmed 10:30AM

from its role as the measurer of tar and nicotine content.

It's conceivable that some other ad, an ad not dealing with tar and nicotine content, might be 10:31AM the subject of some sort of regulatory process. But that would be something different from an ad based on the allegation that they were trying to trick the cigarette smoking machines.

Q While you were at the FTC, did you have 10:31AM occasion to review any case that was based on cigarette advertising apart from the case having to do with the filter?

A No, I don't think so. And, in fact, I have this recollection that for some reason we 10:31AM steered clear, for the most part, of tobacco advertising, except, again, I keep coming back to this one exception, based on the FTC's rather unusual role as a smoker of cigarettes.

Q Why do you say your recollection is that 10:31AM you steered clear of cigarette advertising?

A I don't remember why, to be perfectly honest with you, but I certainly don't remember seeing any cases that involved cigarettes.

Q Are you going to offer any opinions about 10:32AM cigarette advertising or marketing in this case? 10:32AM

A Just general propositions about cigarette marketing?

Q Just any opinions at all. Are you going to offer any opinions about cigarette advertising or 10:32AM marketing in this case?

A Well, it's possible that when I'm talking about punitive damages, for example, that allegations made about the advertising would be germane to what I'm saying about punitive damages, 10:32AM but I would be just assuming certain things about the ads rather than offering my own opinion based on some independent inquiry of my own.

I don't know if that answers your question or not, but... 10:32AM

Q What would you be assuming about the ads?

A Well, if we're talking about punitive damages, one of the principal things that I would be assuming would be that what the advertising said to merit punitive damages was fraudulent or deceptive 10:33AM or something along those lines, constituted a material misrepresentation.

Q What would you base that assumption on?

A Something that is, as I understand it, is to be demonstrated at this trial. 10:33AM

I believe that some of the cases that 10:33AM

Mr. Piuze asked me to take a look at have involved allegations of that sort.

Q Are you aware of any cases -- pardon me. Let me rephrase that. 10:34AM

Are these cases in which liability has been premised on the notion that cigarette advertising has been fraudulent or deceptive?

A I'm sorry. Could you repeat that question? 10:34AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Sure.
Are these cases, the cases you just referred to that Mr. Piuze has given you to look at, are these cases where liability has been based on the notion that cigarette advertising is fraudulent or deceptive? 10:34AM
A I believe in those cases that liability was based, at least in part, on those grounds.
Q Are you aware of any cases in which allegations of fraudulent or deceptive advertising have been rejected by juries -- and let me rephrase that to be clear -- fraudulent or deceptive advertising by the tobacco industry has been rejected as a liability by jurors? 10:34AM
A I have a general sense that such cases do exist, but I'm not aware of any one of them in particular. 10:34AM

Q Have you gone out to do any kind of search on your own to determine whether or not allegations of fraudulent or deceptive advertising by the tobacco industry have been rejected by courts or juries? 10:35AM
A Independent investigation on my own, no.
Q Do you intend to do anything like that?
A No. 10:35AM
Q On Exhibit 1, if you would, please, could you put a mark next to every article, book, chapter or other publication that you've got there that has to do with the subject of punitive damages?
A Okay. If I'm not sure, can I indicate it with a question mark? 10:35AM
Q Please. That would be helpful.
A I'll put a little "x" in a circle.
The question again is any article that mentions punitive damages, is that -- 10:38AM
Q That discusses punitive damages. If it just mentions it, I'm not as interested. If there is a substantive discussion --
A Okay.
Q Even if the discussion is in passing, I would like to know that. 10:38AM 10:38AM

A Okay. Okay.
Q Thank you.
Just so our record is complete, you have put an "X" and a question mark next to an article entitled "Boxed In: Economists and the Benefits of Crime." 10:40AM
And that's an article in which you think you may have discussed punitive damages, but you're not sure? 10:40AM
A That is correct, sir.
Q The next article is "Deception Trademark Infringement and the Lanham Act: A Property-Rights Reconciliation."
And again, that's an article in which you think you may have discussed punitive damages, but you're not sure? 10:40AM
A That's right. I almost didn't even indicate that one, but just to be sure I put it down. 10:41AM
Q Okay. The next article also has an "X"

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

and question mark to it; title of "Bargaining Costs, Bargaining Benefits and Compulsory Non-Bargaining Rules."

Again, you think this is an article that may discuss punitive damages, but you're not sure? 10:41AM

A That's right. Even if it's in there, I think it's a possibility, I would rather err of being a possibility.

Q The next article that has an "X" next to it entitled "Do Liability Rules Deter Takings?" 10:41AM

This is an article you do discuss punitive damages?

A I think I did, and let me just -- to clarify about that article, that article appeared in a book, and it is fairly derivative of the one on the next page in the California Law Review, 1990. Because the California piece talks about punitive damages. I think there's a good likelihood that that derivative piece, as I'm calling it, mentions it, too. 10:41AM 10:42AM

Q The next item on the list, and indeed the last item on the list that you have marked here with an "X," is "An Ordinary Economic Rationale for Extraordinary Legal Sanctions." 10:42AM

And this is an article in which you do discuss punitive damages?

A Yes, sir.

Q And other than what you have marked on here, there are no other publications that you have been an author or co-author of in which you discuss 10:42AM 10:42AM

punitive damages in any substantive way?

A Yes. To the best of my -- to the best of my knowledge, what you just said is a correct statement. 10:42AM

Q Okay. Now, you've been retained to testify on behalf of the plaintiff in this case, correct?

A Yes, sir.

Q Do you know who the plaintiff in this case is? 10:42AM

A I believe it's a Ms. Bullock.

Q Have you ever met the plaintiff?

A No, I have not.

Q Have you read her deposition? 10:42AM

A I have not.

Q Do you know who the defendants in this case are?

A Philip Morris is one.

Q Any others that you're aware of? 10:43AM

A No, sir.

Q Have you ever read any of the depositions of any of Philip Morris's managers or executives?

A No, sir.

Q Who approached you about working on this case? 10:43AM 10:43AM

A I was approached by Mr. Piuze.

Q And when did Mr. Piuze approach you?

A Sometime last fall. I don't remember exactly when. 10:43AM

Q And how did -- what was your first contact

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

with Mr. Piuze? By telephone? In person?
A It would have been by telephone; perhaps directly with him initially, or perhaps initially with a woman who works in his office.
Q And do you know how Mr. Piuze got your name?
A As I understand it, he got it from Ken Chesebro.
Q And who is Mr. Chesebro?
A He's a lawyer that Mr. Piuze knows.
Q And where's Mr. Chesebro practice?
A I don't know.
Q Do you know who Mr. Chesebro is?
A I've talked to him on the telephone.
Q In what context did you talk to Mr. Chesebro?
A Principally in the same context I was talking with Mr. Piuze. Sometimes -- at least one time I can remember it was a conference call involving Mr. Piuze, Mr. Chesebro and myself.

Q Do you know where Mr. Chesebro practices?
A I don't.
Q Have you been retained by Mr. Chesebro to testify as an expert in any case?
A No, sir. Never met the man.
Q Have you been retained to testify as an expert in any other tobacco case besides the Bullock case?
A In a strange sort of way, there was one case. It didn't really involve -- or what I was doing had nothing to do with the tobacco aspects of the case, but it was a tobacco case.
Q What was that case?
A That probably doesn't tell you very much. I'm sorry.
I don't even remember the name of the case. It was a case or a situation in which, following the Supreme Court's Cipollone opinion. I believe it's spelled C-i-p-p-o-l-o-n-e (sic).
Q I think that's right.
A The firm that approached me wanted me to put together an economics-based -- I don't know if it was an affidavit or report or something like that -- explaining why it made sense for them to be allowed to withdraw from a whole series of pending

cases that this law firm had.
Q And do you remember the name of the law firm?
A Yes, it was Budd, Larner, Gross, somebody else.
Q Do you remember whether they were representing plaintiffs or defendants in those cases?
A Must have been plaintiffs because they wanted to remove themselves from the cases.
Q Now, that's looking backwards.
Is that the only case that you have been -- the only other tobacco case that you have been retained to testify in?
A Yes, sir.
Q Now looking forward, have you been

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

retained to testify in the future in any other tobacco case?
A No, sir. 10:46AM
Q What did Mr. Piuze and Mr. Chesebro tell you when you spoke with them on that conference call?
A They told me they were looking for an economist who would be available to testify about 10:47AM
the value of assessing punitive damages from an 10:47AM

economic standpoint.
Q Did they tell you anything more?
A I think they explained to me the basics of what they expected to be the showings or the bases 10:47AM
for liability in the case. And in effect, I was told, "Assume these things will be shown."
We would then -- said them to me, "We would then be looking for someone to explain what the economic value of punitive damages is." 10:48AM
Q Did either Mr. Chesebro or Mr. Piuze tell you that they had a particular case they wanted you to work on?
A As I recall, this was all specific to the Bullock case. 10:48AM
Q Other than telling you, "Assume certain facts would be shown," did they tell you anything else about the case?
A I don't think so.
Q What did you tell them during the 10:48AM conversation?
A I said to them that I had -- I had no interest in getting involved in the specifics, the details, if you will, on the liability side in the case, but that if a general economic discussion of 10:49AM
the value of punitive damages was what they were 10:49AM

looking for, something along the lines of what I have written in that California article we talked about a minute ago, that I could probably do that.
Q Did Mr. Piuze or Mr. Chesebro tell you how 10:49AM they ended up with your name?
A They had seen my name, I think, on one of the amicus briefs in the cases that -- or whose briefs we've given you here today. My name is on the front page of those. 10:50AM
Q Was there any other way they got your name other than seeing it on the amicus brief?
A Not that I'm aware of. They, of course, would know more about that than I would, but that's all I remember hearing about. They may have through 10:50AM
that or perhaps even independently have seen this article that I wrote. That is certainly a plausible hypothesis, but...
Q But they didn't tell you that they had seen the article you've written? 10:50AM
A I don't remember them saying that, no.
Q Was there anything else that you can remember about that first conversation with Mr. Piuze and Mr. Chesebro?
A No. That's pretty much the gist of it. 10:51AM
It wasn't a very long conversation. And, as I say, 10:51AM

the particular question was would I be potentially

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

available to function in the role they described.
And I told them I would.
Q Were you given any kind of assignment? 10:51AM
A No.
Q After that first conversation last fall, when was the next time that you heard from Mr. Piuze or someone from his office?
A Not for quite a while. I would say 10:51AM probably not until maybe January or February.
Q Between the first conversation you had with Mr. Piuze and Mr. Chesebro and the next time you heard from anyone in Mr. Piuze's office, did you do any work on the case? 10:51AM
A No.
Q The second conversation with someone from Mr. Piuze's office, who did you have that conversation with?
A Her name is Paula Lawlor. 10:52AM
Q What did you and Ms. Lawlor discuss?
A Usually when I talked to Paula Lawlor, it was just to arrange things, logistical, such as would I be available for a phone call, or as time went by and I hadn't heard from them for a while, 10:52AM she may have called to say, "Just want you to know 10:52AM

31

that things are going along, but we haven't had any reason to get back in touch with you"; but things of, like I say, a logistical sort.
Q What was discussed in this conversation in 10:52AM January, if you can recall?
A This was, I think, when the conference call I mentioned before took place, or at least it happened somewhere pretty close to that. Again, the same kinds of things, the kind of role I would fill 10:52AM and what I would be doing. And once again, I repeated that I didn't -- I would do this on the basis of what had been shown at trial.
Q I may have misunderstood your earlier testimony, so I need to clarify one thing. The 10:53AM conference call you had with Mr. Piuze and Mr. Chesebro, when was that call?
A That was in, I think, January.
Q Okay. In the fall of 2001, you had a conversation with Mr. Piuze then? 10:53AM
A Yes.
Q Did you have a separate conversation with Mr. Chesebro at that time?
A I might have. I don't frankly remember, but it is certainly a possibility. 10:53AM
Q And do you recall in such a conversation 10:53AM

32

whether Mr. Chesebro was calling to talk to you about the Bullock case?
A If he called then, that's what he would have called about, yes, sir. 10:53AM
Q Okay. So you had a conference call then in January with Mr. Piuze and Mr. Chesebro, correct?
A Yes. Yes.
Q What was discussed on that conference call? 10:54AM
A The subject of the discussion was not very different from the prior discussions. The point of it, I think, was just to, since I had not heard from

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

anybody for a while, was to say, "All right. Now we're getting to the stage where we have got trial dates, and we need to be thinking about how to get you involved in this." 10:54AM

Q So it was more a discussion of logistics?

A And once again, going over what we had already talked about before. 10:54AM

Q And, again, Mr. Piuze and Mr. Chesebro told you to assume certain facts?

A Well, assume them or assume they will be shown at trial, yes, but...

Q And what did you -- did you say, "Well, if those facts" -- "if I can assume those facts, then 10:54AM 10:54AM

here's what my opinion would be"?

A If -- yes, if those facts turn out to be true facts, so to speak, then yes, my explaining the economic role of punitive damages would be something that I could do. 10:55AM

Q What -- do you remember specifically what the facts were that Mr. Piuze and Mr. Chesebro told you to assume would be proven at trial?

A Well, as I sit here today, I'm not -- it was something along the lines of what we talked about before; that there had been intentional false deceptive statements, misrepresentations made that resulted in the plaintiff incurring injuries from using the product that was advertised falsely. 10:55AM

Q Did you tell Mr. Piuze and Mr. Chesebro, "Assuming those facts are all shown at trial, this is what my opinion would be"?

A I think what I said was if those facts were proven to be true, that the kind of thing that I had written about before would then apply; in other words, those facts having been shown satisfy all the assumptions that go into the economic case for punitive damages that I was making and what I was writing. 10:56AM 10:57AM

Q Okay. Do you remember anything else that was said on that conference call in January? 10:57AM

A No, sir.

Q After the conference call in January, when was the next time you had a conversation with someone from Mr. Piuze's office? 10:57AM

A Throughout the spring, there were maybe three or four exchanges of phone calls, mostly with Paula Lawlor looking for a date, a time, when this could be done. 10:58AM

Q Other than the logistical conversations, have you had any other substantive conversations with anyone from Mr. Piuze's office?

A With anyone other than Mr. Piuze and Paula Lawlor? 10:58AM

Q No. I mean with anyone from Mr. Piuze's office, including Ms. Lawlor and Mr. Piuze.

A Well, I've had the discussions -- I'm sorry. You lost me there.

Q It was a bad question. I'm sorry. Let me rephrase it. 10:58AM

Other than the conversations we've already talked about --

A Okay.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q -- and the few logistical conversations that you had with Ms. Lawlor to set up dates and so 10:58AM

forth --
A Right.
Q -- have you had any other substantive conversations with anyone from Mr. Piuze's office? 10:58AM
A Well, Mr. Piuze and I had dinner last night, and we talked about the deposition today and what I had read that he had given to me to read.
Q Okay. Let's talk about that.
Where did you -- or how long did you have dinner last evening? 10:58AM
A An hour, hour and a half, something like that.
Q And what did you discuss?
A Actually spent a lot of time talking about things that had nothing to do with this case, but occasionally we would focus on what we were supposed to be talking about. And mostly, I think I just said: Okay, I have read these cases. These are the kinds of things that you have told me are going to be shown in this particular case. So, you know, what you were telling me before was at least a plausible scenario; at least as far as liability in this case seems to be borne out by these cases here. And we talked sort of on that subject generally, but as you can hear from my answers, we really have just 10:59AM 10:59AM 10:59AM

sort of talked about the same things over and over again.
Q Did Mr. Piuze tell you anything about the deposition today? 11:00AM
A Well, he told me it was at 9:30 at 777 South Figueroa, which I already knew.
Q Okay.
A No.
Q Did he tell you anything about the kind of questions to expect? 11:00AM
A No.
Q How much time have you spent working on this case to date?
A Not much. Less than ten hours. 11:00AM
Q Are you being compensated for your time in this case?
A Yes.
Q What is your billing rate in this case?
A Five hundred dollars an hour. 11:00AM
I'm sorry. Let me just go back. When I say "less than ten hours," I'm doing that from memory. It is certainly less than 15 hours.
Q Have you kept time records?
A Yes. 11:00AM
Q Have you sent a bill to Mr. Piuze's office for your time? 11:00AM

A I have not.
Q Are you -- do you have a different rate for your deposition? 11:01AM
A No.
MR. STOEVER: I'm going to ask the court reporter to mark as Exhibit 2 this document.
(Defendants' Exhibit 2 was marked

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

for identification and annexed 11:01AM
hereto.)
BY MR. STOEVER:
Q Exhibit 2 is the notice of expert depositions and notice to produce documents for inspection and copying. And if you would please 11:01AM
turn to the second page, beginning on line 19.
There's a list of items that we have asked all of the experts, including yourself, to bring with them to the deposition. The first is All writings reviewed or that you expect to review in 11:01AM
connection with this case.
Have you produced those today?
A I haven't produced the items that are on my resume, the law review article and the chapter in particular. 11:02AM
Q And do you expect to review those for 11:02AM

38

purposes of your testimony?
A Yes, I would.
Q Other than those two items, are there any other writings that you reviewed or expect to review 11:02AM
in this case that you have not produced to us today?
A No.
Q Item number 2: All writings that refer or relate to communications by the deponent with any person regarding this case. 11:02AM
Have you had any communications, other than what we have already talked about with Mr. Piuze, Mr. Chesebro, Ms. Lawlor, have you had any communications with anyone else regarding this case? 11:02AM
A Well, I have letters from Mr. Piuze notifying me that I have been engaged in the case, that kind of thing.
Q Have you produced any of that correspondence today? 11:03AM
A No, I have not.
Q Do you have a file in your office in which you keep all the papers in this case?
A Yes. Yes.
Q Have you produced the entire contents of 11:03AM
that file today? 11:03AM

39

A No.
Q Item number 3 is All writings prepared by the deponent or at his request regarding this case including reports, memoranda and notes. 11:03AM
Have you produced any writings regarding this case?
A No, I have not.
Q Have any writings been produced at your request? 11:03AM
A Other than what we just gave you, I don't know what "writings" includes.
Q Let me rephrase that.
A Okay.
Q Any original writings; in other words, 11:03AM
have you asked a research assistant or someone working with you to generate a memoranda? I realize these are all writings. I'm talking about things original and related to the case.
A I understand now. 11:03AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

There is nothing that matches that description; no such reports, memoranda or notes exist.

Q Item number 4: All writings that refer or relate to the amount of time the deponent spent on any matter relating to this case, including time 11:03AM 11:04AM

40

sheets, billing records and invoices.

You said a moment ago you keep time sheets, correct?

A Yes, I do. 11:04AM

Q Have you produced those?

A No, I haven't. I was not informed, frankly, that I was supposed to be doing this, so --

Q Okay.

A -- so that's the only reason you don't. 11:04AM

If you're supposed to have them and you don't, it's just because I didn't know I was supposed to bring them.

Q Let's go through the end of the list here: All items that refer or relate to the amount the deponent has charged, or will charge in the future, for his services in this case, again, including time sheets and billing records and invoices. 11:04AM

You mentioned you have time sheets. Do you have any other writings that refer to your billing or charges? 11:04AM

A There is correspondence relating to my being engaged in the case that I mentioned to you before.

Q Item number 6: All writings that refer or relate to each contact the deponent has had with 11:04AM 11:04AM

41

anyone involved in this case, including handwritten notes and memoranda.

Do you have any such notes or memoranda?

A No, sir. 11:04AM

Q Do you have any notes at all that refer or relate to the contact with persons you have had in this case?

A No. And there have been no such contacts other than ones which I described. 11:05AM

Q You didn't take notes during your conference call with Mr. Piuze and Mr. Chesebro?

A I have not.

Q All writings that refer or relate to any agreement for the retention of the deponent as an expert witness in this case, including retainer letters and fee agreements. 11:05AM

You do have those, correct?

A Yes, I do.

Q Item number 8: The entire file maintained by the deponent in regard to this case. 11:05AM

And there is a file, isn't there?

A Yes, sir.

MR. STOEVER: Mr. Piuze, we would ask these items be produced to us as soon as possible. 11:05AM

MR. PIUZE: I apologize. My law firm or 11:05AM

42

Ms. Lawlor will go to the firing squad immediately.

I don't want to be presumptuous here. The answer is yes, and perhaps if you asked a further question to "what you have that we don't have," my 11:05AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

guess would be the time sheets and the letters we sent him and nothing else. That's a just a guess on my part, but just so you'll rest --

MR. STOEVER: That's a good suggestion. Let me ask that question. 11:06AM

BY MR. STOEVER:

Q What is in your file other than what you have produced to us today?

A Principally these communications relating to the retention and then the time stuff. 11:06AM

MR. STOEVER: Okay. Very good.

And we would ask to get those as soon as possible.

MR. PIUZE: My answer is yes, as soon as the witness gets back to where he's got that stuff, 11:06AM he can send it to me, and I'll send it to you.

MR. STOEVER: Thank you.

MR. PIUZE: Or if you rather, he can send it directly to you.

MR. STOEVER: Whichever you prefer. 11:06AM

MR. PIUZE: Okay. Why don't we 11:06AM

simultaneously send him a copy? How's that? Please.

BY MR. STOEVER:

Q You'll send a copy to both me at Arnold & Porter and Mr. Piuze, correct? 11:06AM

A If you have a card.

Q I'll be happy to give you my card.

A Great.

Q Let me ask you a couple of questions about the documents you produced to us today. 11:06AM

There are what appear to be three briefs filed in the Supreme Court of the United States; two in the case of BMW of North America, Inc. versus Ira Gore. 11:07AM

Are these -- who gave you these two briefs filed in the BMW case?

A Well, these particular copies were given to me by Paula Lawlor.

Q And did you ask her to send you those? 11:07AM

A I had said that I would probably want to review these things before my courtroom testimony, and so she just made a copy and gave it to me.

Q The next brief is from the case TXO Production Corp. vs Alliance Resources Corp. And I 11:07AM note that you're counsel of record on this amicus 11:07AM

curiae brief.

Where did you get this brief?

A This particular copy, you mean?

Q Yes, sir. 11:08AM

A Again, it was given to me by Paula Lawlor.

Q Did you ask her to send you that?

A Same response as to the previous briefs.

Q The next document is the Statement of Decision Re: defendants' motions for a new trial and 11:08AM for judgment notwithstanding the verdict of Richard Boeken vs Philip Morris, Incorporated.

Where did you get this document, sir?

A From Paula Morris -- not Paula Morris -- Paula Lawlor. 11:08AM

Q Did you ask her to send this to you?

http://legacy.library.ucsf.edu/tid/suq37a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A It's part of what I had said generally I would want to know I was being asked to assume. I don't think I asked for that specific case, but I had said that I would like to get some sense of what is going to be shown. 11:08AM

Q The next document is the decision of the court of appeals in the case of Henley vs Philip Morris.

Where did you get this document? 11:09AM

A Again, from Paula. 11:09AM

Q And this, again, was part of what she sent you in response to your request to see what would be shown?

A Yes. Yes, same as with the other case. 11:09AM

Q And the last document that you have produced to us today is titled Opinion and Order on Defendant's Motions for New Trial and for Judgment, Notwithstanding the Verdict in the Henley vs Philip Morris case. 11:09AM

This, too, came from Paula Lawlor?

A Yes, sir.

Q And it came in response to what might be shown in the Bullock case?

A Yes, sir. 11:09AM

MR. PIUZE: If you don't mind, I should point out for the record that none of those are the complete opinions. All of those are just the portions of the opinions in which either the judge or the justice involved summarizes the facts shown in the case. 11:09AM

MR. STOEVER: Thank you.

BY MR. STOEVER:

Q Did you ask for the complete opinions?

A No, I didn't. 11:09AM

Q Were you at all interested in the complete opinions? 11:10AM

A Unless there was something that related to the facts that were found in the case, the answer would be no. 11:10AM

Q Have you gone out and done any independent research, looking for other cases in which Philip Morris or another tobacco company has been involved?

A No, sir.

Q So your opinions in this case are based entirely on the materials sent to you by Mr. Piuze's firm and the articles in your resume, the book chapter and the California review article? 11:10AM

A Up to present, that's correct; and prospectively what will be shown at trial. 11:10AM

Q Do you plan to gather any more information for purposes of preparing your opinions in this case?

A No, sir. That isn't to say something might not come to my attention, but at this point, I have no plans of doing that. 11:11AM

MR. STOEVER: I would like to mark two documents as exhibits.

Would you mark this as Exhibit 3.

(Defendants' Exhibit 3 was marked 11:11AM

for identification and annexed 11:11AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

hereto.)
MR. STOEVER: And this as Exhibit 4, please.
(Defendants' Exhibit 4 was marked for identification and annexed hereto.) 11:11AM
BY MR. STOEVER:
Q Exhibit 3 is a document entitled Plaintiff's Expert Witness List. 11:11AM
And let me ask you, have you seen that document before?
A It's possible that I have. I don't remember.
Q Would you turn to page 8 of the document? 11:12AM
A Yes.
Q Do you see paragraph No. 11?
A Yes.
Q Did you -- have you seen paragraph No. 11 before? 11:12AM
A I saw it when Mr. Piuze showed it to me, yes.
Q When did Mr. Piuze show that to you?
A Either he sent it to me earlier, or certainly this morning he showed it to me again. 11:12AM
Q Did you draft that? 11:12AM

A No.
Q Did you review it in draft?
A It may be something that we talked about on the phone, but I don't remember ever reviewing 11:12AM any hard copy on this.
Q Let me show you what has been marked as Exhibit 4. This is a document that Mr. Piuze handed me this morning which has -- which is a copy of paragraph 11 in Exhibit 3 with some text lined out, 11:12AM and ask you, have you seen Exhibit 4 before?
A Yes. This is what Mr. Piuze showed me this morning.
Q Okay. Did Mr. Piuze tell you why he had lined out the text in paragraph 11? 11:13AM
A No, he did not.
Q Did you and Mr. Piuze discuss the possibility of lining out this language when you met last evening?
A No. 11:13AM
Q Do you understand that Exhibit 4 represents the scope of the opinions that you will give at trial in this case?
A Yes, although I will say that we've had very little discussion on some of this, at least. 11:13AM
MR. PIUZE: Mr. Stoever, if I could, I put 11:14AM

lines through that stuff to save everyone here time and effort. And if I didn't put enough lines through it, I apologize, and I invite anyone, you or the witness, to put lines through the other stuff 11:14AM that isn't correct, also.
BY MR. STOEVER:
Q Well, why don't we take Mr. Piuze's invitation.
Is there any other information in 11:14AM paragraph 11 that you would like to line out?
A There are things here that certainly I

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Digitized by http://www.industrydocuments.ucsf.edu/docs/hxhl0001

could do, if as an economist, if Mr. Piuze asked me to get involved with them, but we have not talked about my being involved with anything that involves setting a specific dollar figure on the amount of punitive damages. And I'm not sure -- I just, for myself at least, wouldn't want the language that comes after the lined-out material to be interpreted as my offering myself to talk about what specific dollar figures would be appropriate for the damages. 11:14AM 11:15AM

MR. PIUZE: Mr. Stoever, I apologize.

THE WITNESS: That's okay.

MR. PIUZE: Mr. Stoever, if you don't mind, I'll jump in again. 11:15AM

I specifically am not going to ask this witness anything about dollar amounts or any numbers. This has to do more with theory, and it does not have to do with numbers. I think that is for the jury to decide, the numbers. 11:15AM 11:15AM

50

BY MR. STOEVER:

Q Just so we're clear, you have not formulated -- based on the information you reviewed, you have not formulated in your mind a specific dollar amount that the jury should award in punitive damages in this case? 11:16AM

A That statement is correct.

Q Have you formulated a range for punitive damages in this case?

A No. And as far as I know, I will not be asked to do so. 11:16AM

MR. PIUZE: He will not.

BY MR. STOEVER:

Q Exhibit 3 indicates that you may testify about the amount of Philip Morris's past profits attributable to the sale of cigarettes. Exhibit 4 has lined that language out. 11:17AM

Is it true that you will not offer any opinions about Philip Morris's past profits attributable to the sale of cigarettes? 11:17AM

A It is my understanding that I will not offer any testimony along those lines. 11:17AM

51

Q Have you done any work to try to determine the amount of Philip Morris's past profits?

A None. 11:17AM

Q Exhibit 3 indicates that you will testify about the present financial condition of Philip Morris. Exhibit 4 has that language lined out.

Is it true that you will not offer any opinions at trial about the present financial condition of Philip Morris? 11:17AM

A It is true that I will not, as I understand it, be offering any testimony along those lines.

Q Have you done any work to determine the present financial condition of Philip Morris? 11:17AM

A I have not.

Q Exhibit 3 indicates that you will testify about the relative reprehensibility of Philip Morris's conduct. Exhibit 4 has that language lined out. 11:18AM

Is it the case you are not going to offer opinions about the relative reprehensibility of

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Digitized by http://industrydocuments.ucsf.edu/docs/hxhl0001

Philip Morris's conduct at trial?
A It is my understanding it is not testimony 11:18AM
I will offer. 11:18AM

52

Q Have you done any work to determine the relative reprehensibility of Philip Morris's conduct?
A No. 11:18AM
Q The next item which appears in both Exhibit 3 and Exhibit 4 is: What methods of analysis may sensibly be used by factfinders; combine factual findings on past profits, present financial condition, reprehensibility and other 11:18AM
pertinent factors in setting a dollar figure for an amount of punitive damages adequate to punish Philip Morris's past culpability and therefore deter future conduct by Philip Morris and others in the future.
Did I read that correct, sir? 11:19AM
A I believe you did.
Q As I understand what you told me and what Mr. Piuze told me, you are not talking about setting a dollar figure for amount of punitive damages. Is that correct? 11:19AM
A That is correct, sir.
Q Can you hand me Exhibit 4?
If I may just reach across the table.
If I just struck the words "setting a dollar figure for an," would that -- and I'll just 11:19AM
put little brackets around those. Actually, I take 11:19AM

53

it back. The brackets should be around "a dollar figure for."
Should that language be struck, "a dollar figure for"? 11:20AM
A Perhaps Mr. Piuze ought to take a look at this as well. You see what he did?
MR. PIUZE: Sure.
If what -- well, I didn't see, but I heard. If what he did is he struck the words "a 11:20AM
dollar figure for," I think that's fine.
THE WITNESS: Uh-huh.
MR. PIUZE: If the witness thinks it's fine, I think it's fine.
THE WITNESS: Uh-huh, yes. 11:20AM
BY MR. STOEVER:
Q Okay. I'm going to go ahead and put a line through that on Exhibit 4. And I would like you to take a look at it and initial it in the margin there, if that is an accurate description of 11:20AM
your testimony based on what we have just talked about.
A (As requested.)
Q Thank you.
I'll give the exhibit back to you. 11:21AM
This sentence describing your -- the 11:21AM

54

opinions you intend to offer discusses several factual findings; findings about past profits, present financial condition, reprehensibility and other pertinent factors. 11:21AM
Are these the assumptions that Mr. Piuze and Mr. Chesebro told you about when you spoke to them on that conference call?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

A They may have been mentioned, but they were not the principal assumptions that we were talking about. We were talking about the assumptions that went to issues of liability rather than issues of damages.

Q This also lists other pertinent factors. What are other pertinent factors? 11:22AM

A There's no mention, specifically, here of the probabilities of being apprehended. That would be something that would go into a desirable -- an economically desirable calculation. So that's one that just comes to mind right off the bat. 11:22AM

Q Are there other pertinent factors you can think of?

A As I sit here now, no, but there may be others.

Q Exhibit 4 suggests that the purpose for punitive damages, in your view -- in your view, the 11:23AM

purpose for punitive damages would be to punish and deter Philip Morris, correct?

A Yes, sir.

Q Is that your view? 11:23AM

A Is what my view?

Q The purpose of punitive damages is to punish and deter.

A The economic function of punitive damages in my opinion is to do that. There may be other functions that are outside the realm of economics, but I am appearing as an economic expert. 11:23AM

Q Do you know whether California law calls for punishment and deterrence?

A I believe that it does, but I couldn't cite you -- in our discussion -- in our discussions, it's been my understanding that, indeed, the reason I'm involved in this is because a relevant factor under California law is deterrence. 11:23AM

Q And what's that understanding based on? 11:24AM

A Just my discussion with Mr. Piuze.

Q You have not gone out to try to determine what California requires?

A No, sir.

Q How do you punish a corporation? 11:24AM

A Well, you don't actually punish a 11:24AM

corporation. You punish its shareholders. Shareholders are the ones that are directly affected, but the corporation is also punished by having to disgorge the money set in the punitive damage award. 11:24AM

Q But you said two things there. You said -- first, you said you punish the shareholders. Then you said you punish the corporation by having it disgorge the amount of the punitive damage award. 11:25AM

Are those really two different things?

A No.

Q So which is more accurate? Your first statement that you are really punishing the shareholders; or the second statement that you're punishing the corporation? 11:25AM

A Well, I don't think either one is more accurate than the other. They both happen simultaneously.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q When you punish a corporation, are you punishing its managers? 11:25AM

A Indirectly you may well be, sure.

Q How so?

A Well, because if the corporation is punished on the basis of what management has done, then the managers suffer themselves. I mean the Enron directors are not going to find it easy to find jobs once the Enron affair is over. 11:25AM

Q Let's assume that the managers at the corporation are not managers who have been alleged to have done anything wrong. They're managers that -- who come on the scene years after the alleged wrongdoing. 11:26AM

Do you punish those managers when you punish the corporation?

A To the extent that the corporation is less solvent than it used to be, there is certainly an effect on management of the sort you described, yes.

Q Any other punishment that management would suffer? 11:26AM

A Well, there may be, but that's the one that occurs to me.

Q When you punish a corporation, do you punish its employees separate from the managers?

A Not necessarily. I don't see why that would necessarily happen. 11:26AM

Q Well, would employees -- you mentioned managers might lose their jobs. Would employees lose their jobs when you punish a corporation?

A I don't see why necessarily that would take place, no. 11:27AM 11:27AM

Q If you punish a corporation, do you run the risk of the corporation cutting back on some of its programs?

A I suppose there's that possibility. The point is to punish on the basis of activities that were socially undesirable, and so if the activities that are cut back on are the ones that are socially undesirable, that are the focus of the litigation, I suppose what you're saying might happen. But I don't see why it necessarily would, and if it did, why it would necessarily be bad. 11:27AM

Q So is the objective to punish the socially undesirable activities out of existence?

A Yes. 11:28AM

I'm not sure what you mean by punish out of existence, but what I understood by that phrase, punished so they do not recur.

Q You used -- in your article, you used the term "eradication," correct? 11:28AM

A Yes. Yes.

Q And what do you mean when you use that term?

A Just what I said before, punish so that it is no longer economically rational for the wrongdoer to commit the same offenses as before. 11:28AM 11:28AM

Q When you use the word "deter" in paragraph 11 of your expert disclosure, or when that word is used, what does it mean?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Digitized by http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A In the context of punitive damages, it means, again, to prevent wrongdoing defendants and others who will react to what's being done to this particular defendant; so set up a situation where it is no longer economically rational to undertake the activities that are the subject of the punitive damages. 11:28AM 11:29AM

Q Do you intend to offer any opinions about what is necessary to deter Philip Morris?

A When you say "necessary," do you mean a dollar amount? 11:29AM

Q Well, you've already said you're not talking about dollar amounts.

A Right.

Q I'm talking about anything else now, about what would be necessary to deter Philip Morris. 11:29AM

A Other than punitive damages?

Q Other than punitive damages.

A No.

Q And in the context of punitive damages, the only thing that would be necessary to deter Philip Morris is a dollar amount, correct? 11:30AM 11:30AM

A Well, again, I'm here as an economist, and I'm talking about the economic rationale for assessing punitive damages and part of that rationale is an assumption that there is some amount that can be reached that would deter, yes. 11:30AM

Q And that's the rationale for your method of analysis for punitive damages?

A Yes, sir.

Q Will you offer any opinions about what conduct of Philip Morris should be deterred? 11:30AM

A Are you asking would I be offering opinions independent of that which makes up the basis for liability in this case?

Q Yes. 11:31AM

A No, I would not be offering anything that would go beyond the bases for liability in this particular case.

Q And what is your expectation about how you will determine what the basis of liability is in this case? 11:31AM

A I don't understand the question.

Q It's probably a poor question. Let me try again.

You've read a number of documents Mr. Piuze has provided you, correct? 11:31AM 11:31AM

A Some documents, yes.

Q And some of these documents include a discussion of some facts that other juries have determined are a basis for liability for Philip Morris? 11:31AM

A That is correct.

Q Are you going to assume in this case that the jury will find, in this case, will find all of these facts to be true when you offer your opinions in this case? 11:31AM

MR. PIUZE: Well, I have to interject on this point to remind you that you have asked for a bifurcation of this trial, so that any discussion of the amounts of punishment or how to punish is a 11:32AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

separate second phase of the case, and that motion is a mandatory grant, which I haven't opposed and the judge will grant it.

And given the fact you have made that motion, I would think that the jury would have already made the determination. 11:32AM

MR. STOEVER: Well, your point is well taken. And I guess what I was getting to -- and perhaps we can -- you'll just tell me flat out -- it's your intention that Mr. McChesney would only be called in the second phase of the trial. Is that 11:32AM 11:32AM

correct?

MR. PIUZE: No, I don't want to pin myself down to that 100 percent, but that seems to be the logic of it. 11:32AM

Until the jury -- it seems to me now, until the jury makes a determination that Philip Morris deserves to be punished, we don't have to discuss the method or the amount or scope.

MR. STOEVER: I don't disagree with any of that. My only -- if Mr. McChesney shows up in the trial, there will not be such a verdict from the jury. 11:33AM

BY MR. STOEVER:

Q I need to know, if we don't have a verdict from the jury, if you take the stand without the benefit of having a verdict from the jury, would you be -- would your opinions be based on the assumption that the finder of fact in this case would conclude the same facts that the other juries in the other cases that Mr. Piuze has provided to you found in those cases? 11:33AM

A I could certainly be asked to make those assumptions, but it's my understanding that -- and here I hope I understand the basis for the colloquy between the two of you -- it would be my 11:33AM 11:33AM

understanding if I were testifying before the jury had come back on or had rendered a decision on these various factual issues, I would be testifying, assuming that the jury was going to come back and find in a certain way that Mr. Piuze would ask me to assume. And that is not necessarily going to be the same as what the other juries in the other cases found. 11:34AM

Does that respond to your question?

Q I think it does. I think it does. Let me just check. 11:34AM

The amount of compensatory damages awarded is another one of the pertinent factors that is referenced here in your expert witness disclosure.

A I would not think going in, at least, that that would be something that would enter into my discussion. 11:35AM

Q So whether compensatory damages are a dollar or $10 million is irrelevant to your analysis of what punitive damages should be?

A That's correct. As a general matter, that's correct. 11:35AM

Q Will you offer any opinions about the size of the compensatory damages requested?

A Not as I understand it. 11:35AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q And I take it from your testimony a moment ago that you do not believe there should be a relationship between compensatory and punitive damages. 11:35AM

A If you look at the California piece that we referenced before, there's some discussion in there about situations in which this might possibly have some relevance, but those are the exceptional situations. 11:36AM

In the ordinary case, where what you're doing is looking to deter the unacceptable conduct of the defendant, you want to strip the defendant of the gains. And there's no necessary relationship between the gains to the defendant and the losses 11:36AM suffered by the plaintiff in the ordinary situation.

Q Does the law require a relationship between punitive damages and compensatory damages?

A I have the impression, as a casual observer, that there are some states, and there have 11:36AM been some cases, that do talk about things like multiples and what have you.

Q Do you know whether that is true in California?

A I do not know whether that is true in 11:36AM California. 11:36AM

Q Do you intend to determine that before you offer your opinions in this case?

A If this is one of the situations -- and I think it would be -- if the jury were to find along 11:37AM the lines that plaintiff is alleging, then the amount of compensatory damages would not be something that I would think was of importance.

Q Okay. Let me try my question again.

Do you intend to determine whether 11:37AM California law requires there to be a relationship between compensatory and punitive damages before you testify in this case?

A No. No, I do not.

Something of interest. I will probably 11:37AM find out about it, but it has nothing do with the economic merits and the things that go into thinking about how punitive damages ought to be assessed.

MR. STOEVER: Let me ask the court reporter to mark as Exhibit 5 this next document. 11:37AM

(Defendants' Exhibit 5 was marked for identification and annexed hereto.)

BY MR. STOEVER:

Q And would you identify that for the 11:38AM record, please, sir? 11:38AM

A Yes. This is the much spoken of California Law Review article that we've talked about before today.

Q Okay. And this is the California Law 11:38AM Review article that forms the basis for your analysis of punitive damages, correct?

A Yes, sir.

Q And your analysis of punitive damages in this case will, in fact, be based upon this law 11:38AM review article?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A On the mode of analysis set out in this article, yes.
Q The title of the article and all your discussion today suggests that your mode of analysis is based on economic principles. Is that correct? 11:38AM
A Yes.
Q I take it then you are proposing when you -- in this disclosure, when you -- it says you will discuss a method of analysis for the fact finder to use -- and by that, I'm referring to Exhibit 4 now. 11:39AM
A Yes.
Q -- that you are suggesting that the jury use economic principles to formulate a figure for punitive damages in this case. Is that correct? 11:39AM 11:39AM

67

A Well, not exactly. What I'm saying is that to the extent that economic factors, economic thinking is relative to what a jury does by way of reaching its decisions concerning punitive damages, the extent that the economic approach matters, this is the way to think about it. 11:39AM
But as I think I said before, I'm not claiming that California law says this is the only thing that ought to be considered. That deterrence from an economic standpoint is the only thing that ought to be considered. I'm offering no opinions about the law, in other words, that would bind the jury when it makes its conclusions or reaches its conclusions. 11:40AM 11:40AM
Q If you would, please, describe your -- the method of analysis that you set out in Exhibit 5.
A The point of the whole article is that there is, from an economic perspective -- I keep using that term -- there is a good reason in certain factual situations, when certain factual assumptions are met, a good reason to impose punitive damages. And in those situations, what you're looking to do is to -- we use the term "make defendants whole," meaning take away defendants the expected gains from engaging in this kind of activity. 11:40AM 11:41AM 11:41AM

68

And the point of the article is that people, or many people who have written about punitive damages and have analyzed their desirability or nondesirability, have analyzed punitive damages from the standpoint of making plaintiffs whole. 11:41AM
And that's a good way to think about things as concerns certain kinds of activities, where you want a defendant to take into account the cost that the defendants' activities impose on the plaintiff. And you, therefore, want the defendant to treat harming the plaintiff as a cost, just like hiring an additional employee or more materials, more raw materials for production or what have you. 11:42AM 11:42AM
It's a socially useful activity, like manufacturing a car, let's say, but we want the manufacturer to take into account all the costs that the manufacturer imposes on people.
So if the manufacturing involves air pollution, for example, well, we want to make sure that we, in effect, price the air pollution, i.e., 11:42AM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

what damage is done to plaintiffs, so that the manufacturer has to take that cost into account and adjust its level of activity accordingly.

But again, that whole notion of making

plaintiffs whole and forcing defendants to consider plaintiffs' losses as costs presupposes that this is a socially useful activity in the first place. If it's an activity whose optimal level is zero -- and we're going back to a discussion that we touched on a little bit earlier here -- if the optimal level of the activity is zero, then you want -- you don't want the defendant to take into account the harm to plaintiffs and treat it as a cost. You want the defendant to stop doing this thing altogether. And so you've got to take away, strip away all of the gains that defendants realize from their particular activity.

So, for example, the optimal level of producing cars is the one that takes into account all the costs imposed on plaintiffs from the pollution activity, in our example.

But the optimal level of murder is zero. We don't want any murder at all. So we don't go around in our criminal law system and say, well, as long as you're willing to compensate plaintiff or plaintiff's estate or plaintiff's spouse, whoever it might be, for the cost you have imposed by killing this plaintiff -- the decedent -- we don't want people to treat murder as just a price of an

activity. We want them to not murder anybody, so we take away all the gains. We make it so costly -- or at least that's the theory -- we make it so costly to do it, capital punishment, life imprisonment, life without parole, whatever it might be, we get zero activity.

I realize it's a very winded answer. It's not a short piece, but that's the basic thrust of the article.

And then we -- once we've established that, we go on and try to show that, in fact, this distinction between making plaintiffs whole and making defendants whole, i.e., stripping all gains from defendants, actually explains a whole series of rules of liability and remedies that have puzzled a lot of people who have looked at them.

Q And what are those liabilities and remedies? Punitive damages is one?

A Punitive damages; injunctions. Talked about the collateral source rule in here. There's a whole series of things that we say once you've got this basic distinction between making plaintiffs whole and making defendants whole. Once you've got that clear in your mind, then all of these things really all fit under that one single umbrella and

life becomes a lot simpler. We have our legal, quote, Occam's Razor; don't complicate what doesn't need to be complicated.

Could we take a break for a minute? I'm getting a little dry.

MR. STOEVER: Of course. Of course.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Sure. We'll take a little break.
(Discussion off the record.)
BY MR. STOEVER: 11:57AM
Q Okay. Let me go back and see if I understand your -- the explanation you have given about the method of analysis in your article.
Is it correct that the goal of your method of analysis is to discourage socially unacceptable 11:57AM or social activity that has no value? Is that correct?
A The point of the article -- I think what you're saying is this -- if not, you'll correct me -- the point of the article is that there are 11:58AM certain activities that have no social value, whose optimal rate of occurrence therefore is zero, and the economic case for punitive damages is deterrence of those kinds of activities.
Q Okay. Are there any other objectives for 11:58AM your method of analysis? 11:58AM

72

A I don't understand the question.
Q Well, one goal would be to deter activities that have no social value, correct?
A Well, all we're saying is there are such 11:58AM activities, and in an economically efficient system, punitive damages is a mechanism for eradicating, to use the term we employed before, these activities whose optimal rate of occurrence is zero.
Q Okay. Would it be correct to say that one 11:59AM goal is to deter activities that have no social value?
A Yes.
Q Are there any other goals?
A Any other goals for allowing juries to 11:59AM impose punitive damages?
Q No. Any other goals for your method of analysis.
A Well, I don't know that we have a goal. The word "goal" is kind of hanging me up. 11:59AM
Q Okay.
A All we're saying is that, from an economic standpoint, there is a case for punitive damages based on deterrence, and here's how it works.
Q From an economic standpoint, is there a 11:59AM case for punitive damages based on punishment? 11:59AM

73

A I don't know what the distinction is you are drawing between deterrence and punishment.
Q Is it your position that deterrence and punishment are the same thing? 11:59AM
A Well, we're talking about deterrence through punitive damages. If they're punitive, they're punishing, as I understand the terms.
So, yes, it's punishment through deterrence, achieved by the imposition of punitive 12:00PM damages.
Q Is it punishment with the objective of deterrence?
A From an economic standpoint, that would be the reason to have it, yes. 12:00PM
Q Okay.
A Or at least from the economic standpoint as we presented here.

http://legacy.library.ucsf.edu/tid/suc07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Okay. Is one objective of punitive damages, as you have analyzed it, to reward the plaintiff?
A To the extent that the punitive damages exceed the compensatory damages, the plaintiff is rewarded. But the point of the analysis is the deterrence of defendants. 12:00PM 12:01PM
It is true that as a by-product that 12:01PM

74

plaintiffs will sometimes receive more than their compensatory damages.
Q Is that -- from an economic standpoint, is the amount that plaintiffs receive in excess of their punitive damages -- pardon me -- in excess of their compensatory damages a windfall? 12:01PM
A I guess you have to define "windfall" for me. If by "windfall" you mean --
Q Isn't there a body of literature out there that discusses punitive damages from an economic perspective and notes that punitive damages are, in fact, a windfall for the plaintiff? 12:01PM
A There might be. But where are the damages going to go? You give them to the government, it's a windfall for the government. 12:02PM
Q Well, in fact, you suggest in your article the possibility of giving punitive damages to the government, don't you?
A That's one possibility, yes, in certain kinds of situations where you're worried about so-called eager victims, is one situation we talk about. But then it's a windfall for the government under -- if you mean something more than compensatory damages because when you give them to the government, the government hasn't suffered any 12:02PM 12:02PM

75

losses at all to begin with.
Q As a matter of fact, if the purpose of punitive damages is to deter activity that has no social value. 12:02PM
Aren't punitive damages really to serve society?
A As we talk about this, it doesn't matter where the money goes in most instances. It's just a transfer payment. The money is not gone. The point is to create a set of incentives that deter the defendants. 12:02PM
Q In your opinion, do punitive damages encourage plaintiffs to act as private attorneys general? 12:03PM
A If you mean by that question, does the possibility of punitive damages increase the incentive of plaintiffs to bring lawsuits -- is that what you mean?
Q Yes. 12:03PM
A -- I would assume the answer to that is yes.
I have never seen any -- I mean it's an empirical question. I have never seen anything that would resolve it as an empirical, would be my assumption or presupposition would be yes. 12:04PM 12:04PM

76

Q You have never done any study of that?
A No.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Digitized by http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q You have never reviewed any literature studying that?
A I don't even know that any exists. I have never heard of it.
Q In your article, you describe punitive damages as the most studied extraordinary remedy.
A Yes.
Q Is that still true?
A Well, that was 12 years ago. I don't know whether it's true or not. I haven't gone and looked to see whether that's the case.
Q Is it still true that punitive damages is treated with skepticism and hostility by most law and economic scholars?
A No, I think that's changed quite a lot.
Q Why do you think that?
A First of all, the reception this article received was highly favorable, and many people said, Oh, we see that what you're saying makes sense; there is a distinction between these two kinds of activities; and therefore, there ought to be a difference in making plaintiffs whole and making defendants whole.

There has also been, it's my impression -- or there have been subsequent articles written that have also gone into this question of whether or not it makes sense to focus more on stripping defendants of gain than on making plaintiffs whole.
Q What are some of those articles?
A I think there's a piece by Shavell, at least as a co-author, that goes into this. And I think there have been more, but I don't remember them as I sit here.
Q Would these -- do these articles cite your piece?
A I think so.
Q Other than the reception that this article received, as well as the piece by Shavell and maybe one or two others, is there any other basis that you have for thinking that the statement made in your article that punitive damages is treated with skepticism and hostility by law and economic scholars has changed?
A Other than the things that I just mentioned to you?
Q Yes, sir.
A No.
Q Is it still the case that the trend of

punitive tort awards -- pardon me.
Is it still the case that the scholars believe the trend of punitive tort awards is unprincipled and counter-productive?
A There may be some who think that.
Q Was that the case when you wrote the article in 1990?
A I think there was considerable skepticism about the value, from an economic standpoint, the value of punitive damages.
Q Do you think most law and economic scholars still think that the recent trend of tort awards is unprincipled and counterproductive?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A Well, we have to define our terms here and make sure we're talking about the same things. This article doesn't talk about whether or not punitive damages are awarded in the appropriate set of cases, but not in the inappropriate set of cases. It doesn't talk about that at all. 12:07PM

It doesn't talk about whether or not, even if the set of cases is the appropriate set of cases, whether the amounts awarded are the appropriate amounts. Those are all interesting questions. They're factual questions, but they're not the questions we're talking about here. 12:07PM

The title is An Economic Rationale. There are a lot of rationales for things out there, but then when you go out and look to see, Well, is this what people are actually doing? The answer is no. 12:08PM

Q Let me interrupt you.

In the article, you write that, Scholars believe the recent trend of tort awards is unprincipled and unproductive.

I take it that was true in 1990, when you wrote the article. 12:08PM

A That was our understanding what other people were saying in 1990, right.

Q Is that still your understanding what other people are saying in 2002? 12:08PM

A I do not know what people are saying in 2002.

Q You also write in the article that, "Scholars believe that punitive damages overcompensate plaintiffs and over-deter potential defendants." 12:08PM

Was that true in --

A What page are you looking at, please?

Q Page 5, in the second full paragraph, about three, four lines down. 12:09PM

A Right. Then there are all citations to 12:09PM

the people that said it.

Q Right.

A Right.

Q All I'm asking you is that was your belief in 1990, when you wrote the article, correct? 12:09PM

A It was our belief that the articles we cited here said that, yes.

Q Has that changed since 1990, to your knowledge? 12:09PM

A No. The articles still say the same thing.

Q Is it still the case that most law and economic scholars believe that punitive damages overcompensate plaintiffs? 12:09PM

A I don't know the answer to that. I think you must be misunderstanding what this paragraph is about.

Q No. I think I understand the paragraph. Maybe my question is not a good one. 12:09PM

I'm just trying to learn whether or not you have determined that the statements that you made in 1990 are still true in 2002?

A I have not revisited the statements made in 1990. 12:10PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q So you don't know where the trend of legal 12:10PM

scholarship is on this subject?
A I have the impression, as I said to you before, that the rationale suggested in this article is coming to be understood and accepted by more 12:10PM people.
Q And what is that -- what is that based on, other than what you have told me? The Shavell article. What else?
A Other pieces that I have seen. 12:10PM
Q Has this method?
A We have some more economists signing on to this brief that say the same thing.
Q Has this method you proposed ever been used by a court in California, to your knowledge? 12:10PM
A It's not something I have ever looked into.
Q Has it ever been presented to a jury anywhere to your knowledge?
A To a jury? 12:10PM
Q Yes. This method of analysis, has it ever been presented to a jury?
A The notion of using punitive damages to deter?
Q No. The notion of making the defendants 12:11PM
whole using the property rules that you use in this 12:11PM

1990 article.
A Well, you don't use property rules. The property rules apply. They exist.
Q Let me try my question again. 12:11PM
A I'm sorry. I'm trying to --
Q That's fine. As I say, it may have been a poor question.
To your knowledge, has the economic rationale for extraordinary legal sanctions you 12:11PM describe in your 1990 California Law Review article been presented to a jury anywhere as a basis for analyzing the amount of punitive damages to award in a case?
A Well, what I understand this article to be 12:11PM suggesting; and therefore, what I assume you're asking, has a jury been approached this way, is the notion that you want punitive damages imposed to deter conduct that has no redeeming social value.
If you're asking me can I tell you a case 12:12PM where deterrence was presented to a jury with citations to this article, I don't know whether that's ever happened or not.
Q Do you know whether a jury has ever been asked, using your terminology here, to make a 12:12PM
defendant whole, in those words? 12:12PM

A Oh, that's not a -- that's not a term that people typically use. We use it in this article for rhetorical effect to contrast the ordinary notion of compensatory damages, i.e., making plaintiffs whole, 12:12PM we termed this phrase, "making defendants whole."
Whether anybody ever used that term, I have no idea. It's not a term that I know even existed before we wrote the article.
Q Do you know whether any courts have relied 12:12PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

on the analysis you have set out in your article in reviewing punitive damage awards?

A Well, again, the method set out is based on imposing damages of sufficiently great magnitude that the activity is deterred entirely. If that's what we're talking about, then I'm certainly under the impression that deterrence is a value that is involved in presentations to juries. 12:13PM

Q Let's make it a simpler question. Do you know if any court, any published opinion, has ever cited to this article? 12:13PM

A I have never looked one way or the other. I don't know one way or the other.

Q Using this method of analysis or -- strike that. 12:13PM

In the realm of punitive damages, is it possible to overcompensate a plaintiff with punitive damages? 12:13PM

A Well, how do you define "overcompensate"?

Q Give the plaintiff more money than he or she is entitled to. 12:14PM

A That's just circular. They're entitled to whatever the legal system says, the jury system gives them.

Q Is there any punitive damage award that, in your view, is too large? 12:14PM

A Well, that's just such an abstract question. You would have to tell me what the facts were and what the amount was and all of those kinds of things. 12:14PM

Q Well, you wrote a brief in the BMW case. Was the award in the BMW case too large, the punitive damage award in the BMW case too large, in your view?

A I don't have an opinion about that. That was not the point on the brief I was on. 12:14PM

Q You have no opinion about whether or not the punitive damage award in that case was too large?

A I have no opinion. 12:14PM

Q You read the facts of the Boeken case. In that case, the jury awarded $3 billion in punitive damages. Was that punitive damage award too large? 12:14PM

A I have no opinion.

Q You read the facts of the Henley case. And I can't remember as I sit here now what the size of the punitive damage award was in that case. 12:15PM

Mr. Piuze, do you remember how much the jury awarded in Henley?

MR. PIUZE: After the plaintiff attorney asked for 15, the jury awarded 50. 12:15PM

MR. STOEVER: So the plaintiff -- it was 50 million, correct?

MR. PIUZE: Plaintiff attorney asked for 15. The jury awarded 50. 12:15PM

BY MR. STOEVER:

Q Was that award too large?

A I don't have any opinion. And in part, you're saying I've read the facts, but I haven't read the facts. I've read the summary of the bases for liability in the opinions, but that's not the 12:15PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

same as the facts.
Q Well, you've read the same kinds of material that you would read before offering your opinion in this case, right? 12:15PM
A It would be one of the things I would look 12:16PM

86

at, if that's what you're asking me about, the actual opinion in the case.
Q Well, let me go back. Are you going to read the trial transcripts before offering your 12:16PM opinion in this case?
A If it seems useful to do so. I mean since there's no -- since we don't have any yet, we don't know what's going to be said. I don't know whether it would be useful or not to do so. 12:16PM
Q How are you going to determine what the finder of fact has found with respect to Philip Morris's liability or absence of liability before you offer opinions in this case?
A I will be -- I will ask to be pointed 12:16PM to -- that would satisfy me that what that case is about is the kind of case that we describe as setting out or justifying an economic approach to awarding punitive damages.
Q And you'll be interested in all of the 12:16PM information or any source of information that might help you understand whether or not those facts exist and underlie the opinions that you would give?
A That's right, with the caveat that, as you'll recall, I'm not going to be involved in 12:17PM offering testimony about amounts. And so whether 12:17PM

87

something is too much, to go back to what you were saying before, is not -- that's not going to be an issue that I feel like I need to resolve or I need to get into. 12:17PM
Q In terms of getting ready to testify in this case, though, you're going to be asked to -- you're going to ask to be pointed to findings of fact that will underlie your opinion, correct?
A Yes. 12:17PM
Q And who are you going to make that request of?
A Presumably Mr. Piuze, for starters. And, of course, I would be asking him for anything that bore on either side of the issue. If I'm going to 12:17PM be testifying, then obviously I need to know everything that is relevant to that particular aspect of this.
Q Are you going to undertake any kind of independent review of the record in the case? 12:18PM
A I might. I might well ask, Well, what is the basis for this? Can you show me where I need to go to read about on that? Is there any adverse testimony, any converse testimony, where would I go to read that, et cetera? Sure. 12:18PM
Q So you'll be doing additional work before 12:18PM

88

you testify, then?
A Whatever I need to do to be certain that the bases for what I'm saying, in fact, hold.
Q Is it possible to over-deter a defendant? 12:18PM
A Well, you'll have to define "over-deter"

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

for me.
Q Let me try it another way. Is it possible to punish a defendant too severely?
A "Too severely" meaning assessing punitive damages that are greater than the amount necessary to fully deter the activity? 12:19PM
Q Yes.
A As a matter of fact, the answer to that must be yes. It must -- if we assume that X dollars is enough to deter, could there be an award X plus Y rather than X, I guess the answer would be yes, that could happen. 12:19PM
Q In your view, what would be the result of an award that punished a defendant too severely? 12:19PM
A It's not an issue that is discussed much in this paper, if at all. What we focus on is the rationale for awarding punitive damages at all, and that rationale includes making sure that the damages are at least a certain amount. For purposes of deterrence, there's no particular impact of 12:20PM 12:20PM

assessing damages, punitive damages, in excess of that amount. If you're already at zero, you have reached the point where you want the defendant to be operating. 12:20PM
Q Well, isn't there an effect of punishing too severely; I mean a defendant is affected by punishment too severe?
A Sure, the defendant is affected.
Q What possible effect on the defendant might a punishment that is too severe have? 12:20PM
A I don't know. Again, the focus of this piece, the focus of my analysis, was what's the economic rationale for punitive damages --
Q And your piece -- 12:20PM
A -- and why punitive damages which by definition exceed compensatory damages can be, from an economic standpoint, a good thing.
Q And sorry. In your piece, you state that efficient law seeks optimal deterrence, correct? 12:21PM
A Optimal deterrence in this case being zero level of activity, correct.
Q Zero level of socially unacceptable activity?
A Correct. 12:21PM
Q So the objective is to deter just enough, 12:21PM

correct?
A Again, it doesn't matter from a standpoint of optimal deterrence whether it's just enough or just enough plus a little more. The optimal level is still reached, and that level is zero. 12:21PM
Q Will you offer any opinions that the jury in this case should punish Philip Morris beyond what is necessary to deter whatever socially unacceptable conduct might exist? 12:21PM
A Any testimony about amounts greater than the amount necessary to reduce the level of socially undesirable activity to zero?
Q Yes.
A I won't suggest to offer. 12:22PM
Q Would you suggest to the jury they should punish Philip Morris what is beyond necessary to

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

reduce socially unacceptable activity to zero?
A As I sit here now, I don't see any reason why I would testify about that or testify to that effect. 12:22PM
Q Your model makes a distinction between standard liability rules and property rules, correct?
A That is correct. 12:22PM
Q What is that distinction? 12:22PM

A The distinction is the one that we talked about before; that in the standard liability rule model, a defendant can undertake the activity and simply pay plaintiff for the losses the plaintiff suffers, as opposed to a situation in which the defendant would be required to get the consent of the property owner. 12:23PM
Go back to our pollution example. You can't just spew smoke out and pay the plaintiffs off. You have to go and negotiate a solution with the plaintiffs in advance as a condition of being able to belch out the smoke. 12:23PM
Q Why is that distinction important for your analysis? 12:23PM
A I think we're just repeating ourselves here, but in the standard liability rule setting, defendants are allowed simply to take the costs that they impose on plaintiffs without plaintiffs' consent, treat them as just another factor, another cost of production, and go ahead and undertake the activity. 12:24PM
In a property rule setting, we don't want people to do the activity at all. We want to deter them from doing it, period. 12:24PM
Q In your view, is it ever appropriate to 12:24PM

use standard liability rules to award punitive damages?
A You mean to use the amount?
Q No. I'm sorry. Let me rephrase it. 12:24PM
In your view, should this analysis that you have proposed be used every time punitive damages are awarded?
A Well, as I think I said before, I'm not claiming that only economic considerations, things like deterrence, I'm not claiming that this is the only thing that legally goes into a punitive damage assessment. That's not the point at all. 12:24PM
If you're interested in the economic case for punitive damages, which is based on deterrence, then what is being discussed in this article is the basis for that, for achieving that particular goal, but it may not be the only goal. 12:25PM
Q What are some of the other goals that you know of that go into determining the proper amount of punitive damages? 12:25PM
A I think we mentioned before that, as a legal matter, there are states that have different either caps or rely on multiples of compensatory damages or whatever it might be. That's really of no relevance whatsoever for what we're talking about here. 12:25PM 12:25PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Just so I'm clear then, when you talk about there may be other factors, you're talking about other legal factors that go into determining punitive damages?
A That's correct.
Q Okay. And that would be things like state law cap on punitive damages, correct?
A Sure. 12:26PM
Q Or a state law, state mandated multiple for punitive damages, correct?
A Yes.
Q Are you aware of any such legal factors that would go into calculating punitive damages in California? 12:26PM
A No.
Q Do you know whether the standard, what you described as the standard liability rules for calculating punitive damages, are the rules in California? 12:26PM
A I don't know what you mean by "the standard liability rules for calculating punitive damages."
Q Well, we were just talking about standard liability rules and property rules for calculating 12:26PM 12:26PM

punitive damages --
A You mean like multiples --
Q -- and you described a distinction to me.
Does California -- do California courts use the standard liability rules, which, to paraphrase, would be making the plaintiff whole, if I understand your explanation for them, or do California courts use the property rules that you have advocated in your piece, making the defendant whole? 12:27PM 12:27PM
A Well, they use some for some things and others for other things, I would assume. That is at least what we're talking about here. There are plenty of situations where standard liability rules make sense. There are others where punitive damages make sense. 12:27PM
Q But every time punitive damages makes sense in your view, the property rules approach should be used, setting apart separate and apart the legal factors that we have talked about? 12:27PM
A I suppose that's an implication of what we're saying, yes. You should think about it in terms of property rules rather than liability rules is what we're saying. 12:28PM
Q Are well-defined property rights a 12:28PM

necessary condition for your model to work?
A What do you mean, "well-defined property rights"?
Q I think you used the term in the article, and let me just see if I can find it here. 12:28PM
MR. MESSENBAUGH: Page 27.
BY MR. STOEVER:
Q Yeah, page 27, at the bottom.
A Okay. 12:28PM
Q You write in the extraordinary sanctions model, "Well- property rights are a necessary condition for the award of punitive damages."

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.tobaccoindustrydocuments.ucsf.edu/docs/hxhl0001

See that?
A Yes. 12:28PM
Q What do you mean by that?
A There's some situations in which the law does not award full ownership, full property protection, to an asset. The standard example we use in here is your automobile on the highway. I 12:29PM don't have to negotiate with all the drivers out there in advance what's going to happen in the event that I hit them, as I would have to do if they had full protection for their property. I'm allowed to plow into other people's car by mistake, not 12:29PM intentionally, and merely compensate them in the 12:29PM

standard liability-type situation.
As long as that's possible, using the framework that this piece and many, many, many others use, there is not full property protection 12:29PM for the automobile. It can be taken, with compensation paid after the fact. It doesn't have to be negotiated before the fact. That's the distinction.
Q Again, so I'm clear, so something that can 12:30PM be taken with compensation after the fact does not have well-defined property rights?
A Doesn't have fully defined and enforced property rights, yes.
Q But something that cannot be taken without 12:30PM some negotiation ex ante has fully formed property rights?
A As long as those -- as long as that property right is also enforced, yes. In other words, it may be the case that this is what somebody 12:30PM is supposed to do, but then they don't do it.
Q You have described the automobile as being something that doesn't have fully formed property rights. Give me examples of things that do have fully formed property rights. 12:30PM
A My house. You can't come and just take my 12:30PM

house; you have to negotiate me for it. My land. Land is an interesting example because there are situations, particularly eminent domain. Eminent domain, i.e., taken by the government sets up a 12:31PM standard liability rule protection. So vis-a-vis the government, you don't have full property protection for your land. But that's the distinction.
Q Okay. 12:31PM
A The government can take it and pay you later, but I can't take yours and pay you later.
Q Is your health something that has fully formed property rights?
A Ordinarily people can't do things to 12:31PM affect your health without your permission, without being negotiated ex ante. If somebody would like -- if somebody would like my kidney in a transplant, they can't just go grab it. They have to talk to me about it. I may be willing to do it, and I may not. 12:31PM
Q So bodily integrity is something that has fully formed property rights, in your view?
A Well, it often does, yes.
Under the draft, again, vis-a-vis the

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

government, no, you didn't have fully formed property rights. The government could take you and 12:32PM
12:32PM

98

pay you and didn't even compensate you. It was subcompensatory.

With the end of the draft, things have shifted from a liability model to a volunteer Army. They have got to compensate you before the fact. 12:32PM

Q And it's possible for someone to negotiate or to consent, as you used the word, in the context of the kidney example, to give up their bodily integrity? 12:32PM

A Sure. It's the difference between rape and prostitution.

Q I take it from what you said, your model, your method of analysis for assessing punitive damages is based on the notion that the plaintiff and defendant have engaged in a transaction. Is that right? 12:32PM

A That there could have been a transaction, but that the defendant has chosen to take rather than negotiate. 12:33PM

Q And when there is a transaction, when there's a bargain for transaction, there should be no liability for punitive damages, correct?

A Well, that depends on whether or not the transaction was entered into appropriately, if you will. If the transaction was on the basis of a guy 12:33PM
12:33PM

99

pulls out a gun and says, "Your money or your life," there's a transaction. The guy hands over his money. But this is not the kind of socially desirable transaction that we would want to allow to be governed by a liability rule. 12:33PM

Likewise, if the contract is not a socially desirable one, then the fact there had been a contract wouldn't -- would not mean there was no basis for punitive damages. 12:34PM

Q You use in your article the example of someone agreeing ahead of time to the publication of scurrilous lies about them, and you indicate that that would be a transaction in which no punitive damages could be assessed. Is that -- 12:34PM

A As long as it was appropriately contracted for. Now, again, when I say "appropriately," we're talking about the person who's agreeing to the publication, being informed what would be published, where it would be published, et cetera; not a transaction in which the consent is given on the basis of false information. 12:34PM

Q Give me a list, if you would, of the elements that you think go into an appropriate transaction. 12:34PM

A Well, for starters, that the transaction 12:34PM

100

takes place on the basis of truthful information, so that I know what I'm being asked to give up, and I know what I'm going to get in exchange.

Q Does the source of that information matter? 12:35PM

A Where I get the information?

Q Yes.

A It's sort of an odd question. Where would

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

the information come from other than between the bargaining parties? 12:35PM

Q Well, in the article, you use the example of hazardous employment in a hazardous occupation.

A Okay.

Q And let's draw that example out. You talk about -- let's say that the hazardous occupation is working in a mine, an underground mine -- 12:35PM

A Okay.

Q -- where the employer and the employees both know all of the hazards associated with that job. 12:36PM

The miners and their employer are able to bargain for a wage, correct?

A Correct.

Q And in that context, if a miner is injured working in the mine, then there's no basis for 12:36PM 12:36PM

assessing punitive damages against the employer, correct?

A The risks are understood. There has been no misrepresentation of the employer about his having taken certain safety measurements, none of that, none of that has taken place. 12:36PM

Q None of that has taken place.

A A lawyer says, "Take a look around. See if this is all right." And then they come to a deal and the wage is charged. 12:36PM

Q Correct.

A Person goes to work. There's nothing -- I hear nothing -- based on what we're talking about in this article, I hear nothing undesirable about that. 12:36PM

Q Let's assume that the employer learns that there's methane gas leaking into the mine and doesn't tell the employees and that obviously raises the hazard of working in the mine, and someone is hurt under that scenario because the employer has withheld the information about the methane gas. The employer is liable for punitive damages, correct? 12:37PM

A This gets a little more complicated because the question arises, well, who has the right; who has the obligation. Does the employer have the obligation to tell the employee, or does 12:37PM 12:37PM

the employer not have an obligation to not tell the employee? But we're not talking about a misrepresentation here. We're just talking about saying nothing. 12:37PM

Q So if the employer -- if the employer doesn't have the obligation to tell the employee and simply says nothing, under those circumstances, should punitive damages be awarded?

A If it turned out that there was something that the employer had done that caused the employee to think that the state of the world was other than what it really was, there would be a basis for punitive damages. 12:38PM

If it's understood all around that -- this is like buying a used car as is. You pay your money, and you take your chances. Then, in my mind, there wouldn't be any basis for punitive liability. 12:38PM

Q The employer in that context would have do something affirmatively to try to mislead the -- 12:38PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

mislead the employee?
A Again, we're assuming that there isn't any obligation. If there's a law out there, let's say, that says the employer has to --
Q We're assuming no obligation. 12:38PM
A Such that the employee would assume that 12:38PM

the employer is going to tell him if there really is methane gas?
Q Right.
A But what you're telling me, the employee 12:38PM has -- him or herself have no right to be told this; there's no right being transgressed, what you're describing and what we're talking about in this article, there wouldn't be any basis for punitive liability. 12:39PM
Q Let's say that the -- going back to my question about the source of the information. Let's say that the employer doesn't tell the employees about the methane gas, but the union learns of the methane gas and the union tells the employees, so 12:39PM the employees know about the gas.
In that scenario, is there any basis for assessing punitive damages against the employer?
A And we're not talking about any statute that would proscribe damages? 12:39PM
Q That's right.
A We're just talking about the kind of thing this article is --
Q That's correct.
A -- dealing with? 12:39PM
Q Not talking about any statute that imposes 12:39PM

an obligation on the employer.
A Okay. So the employee learns about it from the union. The employee now has full information, just the same as if the employer had 12:39PM told the employee. The basis for the contract continues or the ongoing contract continues to be one in which everybody has the correct information?
Q Right.
A I would not see in that situation any 12:40PM justification for imposition of punitive damages.
Q What about a situation in which the same facts, but in this case, the employer says, "Come work in our mine. It's a pretty safe place to work." 12:40PM
The employees hear that statement from the employer, but they also hear the information from the union saying, "Don't go anywhere near that mine. It's full of methane gas."
In that situation, would the employer be 12:41PM liable for punitive damages, under your analysis?
A So he says it's pretty safe, but, in fact, it's not pretty safe?
Q That's right.
A And the employees find out, in fact, it's 12:41PM not pretty safe? 12:41PM

Q So they know.
A There would be a basis for imposition of punitive damages.
Q Okay. Why? 12:41PM

http://legacy.library.ucsf.edu/tid/suc07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A Because the activity in which the employer is engaged, lying, is socially undesirable.
Q And in that situation, even though the employees know that the employer is lying, there would be under your analysis, it would be appropriate to impose punitive damages? 12:41PM
MR. PIUZE: Before you answer that, you just characterized your own example and added something to it. And what you have added is that now not just that the union said it was dangerous, but now that the employee knows it's dangerous. Different question. 12:42PM
MR. STOEVER: Fair enough. Let me recharacterize it.
BY MR. STOEVER: 12:42PM
Q Even though the employees have reason to believe that the employer is lying, there would still be a basis for imposing punitive damages?
A I'm having difficulty with the question for this reason: As I understand it, you're describing a situation in which there isn't any 12:42PM 12:42PM

106

causal connection between the misstatement and damage being suffered.
Q Okay.
A Is that correct? 12:42PM
Q No. No, it's not. Again, let me try to restate the hypothetical.
The employer knows there's methane gas in the mine.
A Okay. 12:42PM
Q The employer says, "Come work in our mine. It's a pretty safe place."
A Right.
Q The union says, "Don't go anywhere near that mine. It's full of methane gas." 12:43PM
Let's say there's an explosion in the mine; workers are injured. In that scenario, is there a basis for imposing punitive damages, using your method of analysis?
A Again, what's causing me a problem here is that you're talking about a situation in which ordinary rules of causation are involved in liability. 12:43PM
Did it cause anybody to do anything different? If it didn't, then there's no liability. 12:43PM
Would there still be a basis for punitive 12:43PM

107

damages? Possibly, if the employer got some advantage from this socially undesirable activity.
But you've assumed away in your fact situation any advantage to the employer because, as I understand your example, nobody believed him. So what gains are there to strip away from the employer? 12:43PM
Q So if there are no gains to strip away from the employer, then there's no punitive damages? 12:44PM
A There would be no punitive damages based on any gain to this particular defendant.
Now, if you want to think about the possibility that in other situations, other employers out there might have some gain from this kind of activity, and in a system of precedents you 12:44PM

http://legacy.library.ucsf.edu/tid/suc07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

want to deter situations where there truly is some gain, that's a whole separate issue. But as long as it's clear that the basis for the imposition of punitive damages is some gain to defendant from the socially undesirable activity -- there isn't any in your hypothetical. It assumes -- to me, you have assumed that away and, therefore, there wouldn't be.

Q Well, wouldn't the gain to the defendant be that the people would go to work in his mine? 12:45PM

A Yeah, but you said nobody believed it. 12:45PM

Q No. I said the union said that there was methane gas in the mine. So the employees had reason to believe that the employer was lying.

A Well, I mean the question is a simple one. 12:45PM Did they give any weight to what the employer said or not? It's got to be one way or the other.

Q So the issue turns on whether or not the employee gave any weight to what the employer said.

A The issue turns on whether there was any 12:45PM weight given to it because if there was no weight given to it, there isn't any gain to the employer from doing it.

Q Now, putting that in the context of this case, is it also then true that whether or not 12:45PM punitive damages should be awarded turns on whether or not the plaintiff gave any weight to what the defendant said?

A Yes.

Q I want to go back to the concept of 12:46PM negotiation for just a minute.

How does that concept work in the context of consumer products?

A What do you mean, how does it work?

Q Well, we talked about instances where 12:46PM people are negotiating directly face to face, 12:46PM

employers and employees.

A Right.

Q In the context of consumer products, consumers don't necessarily deal directly with the 12:46PM manufacturer, do they?

A No.

Q They deal with a retailer or someone in between the manufacturer and the consumer, right?

A Typically. 12:46PM

Q So how does the concept of negotiation work between the manufacturer and the consumer in your analysis?

A Well, not to be technical about it, but consumers have a demand curve for a particular 12:47PM product, which, in part, determines the price they're willing to pay and the amount they're willing to purchase. And the demand curve for the product is influenced or can be influenced by things that the manufacturer does. Advertising is an 12:47PM obvious example. That's why they advertise. They want to increase the demand curve, push out the demand curve for their product.

Q So the negotiation takes place in the context of advertising and demand? 12:47PM

A The negotiation -- 12:47PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Well, the negotiation between manufacturer and consumer takes place in the context of the manufacturer speaking through advertising and the consumer giving feedback in the form of demand? 12:47PM

A Well, that's one way in which consumer product markets work, yes.

Q Are there -- is that the way the market works, to your knowledge, in the cigarette market?

A I think advertising is certainly a factor. 12:48PM

Q What are some of the other factors in the cigarette market?

A That determine the demand for the product?

Q Yes.

A Price. I don't know of anything right 12:48PM now, as I sit here. I have never -- as you and I talked about a little while ago, I have never studied the cigarette industry in particular, so I don't know anything more than what any economist would glean just from daily phenomena. 12:48PM

Q In terms of the negotiation between the cigarette company and the smoker, how does that negotiation take place? Is it through advertising and then demand?

A Well, there isn't any direct negotiation, 12:49PM as you said before. I will use the term 12:49PM

"negotiation" in the way we have been talking about it here.

Q Right.

A The consumer hears advertising messages or 12:49PM gets other information -- doesn't have to be advertising -- about the product, and that influences the consumer's demand.

Q What are some of the other sources of information the smoker might get about cigarettes? 12:49PM

A Reading articles in the paper, I suppose; scientific studies; information from groups that favor or disfavor smoking. Probably a lot of different ways that people can get information about it. Read the Surgeon General's report. 12:49PM

Q So there's lots of different sources about smoking that consumers will have?

A Well, they might have.

Q They might have?

A Yeah. 12:50PM

Q Do you know what sources of information the plaintiff in this case had?

A No.

Q Going back to the example of the mine for a moment. If -- well, I'm sorry. I don't want to 12:50PM do that. Let me ask another question. 12:50PM

In your article -- and earlier today you used the term "eager victim." Remember that?

A Yes.

Q What does that term mean? 12:50PM

A It refers to the possibility that in hopes of getting punitive damages, plaintiffs will fail to take certain precautions or will undertake activities just in hopes of getting the compensatory plus the punitive damages. 12:50PM

Q If a plaintiff -- if a person engages in a dangerous activity knowing that the activity is

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

dangerous, is that an eager victim?
A Well, we're talking about an eager victim in the context of punitive damages. Are we talking about someone who engages in a dangerous activity, knowing that the possibility for punitive damages is there? 12:51PM
Q Well, in your article, you use the example of someone who walks home through a dangerous neighborhood when there is an alternative route which is just as quick and much safer. 12:51PM
A Hopes of getting punitive damages if something bad happens?
Q Uh-huh. 12:51PM
A Yes. 12:51PM

Q That would be an eager victim?
A That's an example of an eager victim. Just as easy to go home the safe way, but you feel like you can get something beyond what your compensatory damages would be if you take the unsafe way. 12:51PM
Q Are punitive damages ever appropriate in a situation where you have an eager victim?
A Well, I think the point that we make in the article is that that's a situation, if you have reason to think that, the punitive damage awards are causing eager victims to come out of the woodwork, so to speak. You might then want to think about having some third party be the recipient of the punitive damages. 12:52PM
Q In your opinion, do the size of verdicts in lawsuits against the tobacco industry bring eager victims out of the woodwork, to use your phrase?
A It's an empirical question about which I have no information. 12:52PM
MR. PIUZE: Can I ask for clarification --
MR. STOEVER: Yes.
MR. PIUZE: -- to make sure I'm following this ball? 12:52PM
Do large punitive damage awards get people 12:52PM

to smoke so that they can contact lung cancer and be dying so they can go to court and get more punitive damages?
MR. STOEVER: No. 12:52PM
MR. PIUZE: Is that the translation?
MR. STOEVER: No, that was not the translation.
MR. PIUZE: Okay.
BY MR. STOEVER:
Q So you have no knowledge as to whether or not the size of punitive awards in suits against the tobacco industry have caused eager victims to come out of the woodwork?
A Again, defining "eager victim" the way we have before, I have no information about that. That's a different question about -- does that mean there are more plaintiffs than there used to be? 12:53PM
Q Are there more plaintiffs than there used to be? 12:53PM
A I don't know, as we talked about before.
Q In your article, you say when a plaintiff can undertake efficient precautions to reduce the

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.tobaccoindustrydocuments.ucsf.edu/docs/hxhl0001

likelihood of property violations, punitive damage should be limited. Is that your view? 12:53PM

A That's an aspect of the eager victim 12:53PM

problem we were just talking about before.

Q What are efficient precautions?

A Those whose costs fall short of the benefits; those that can be taken with some benefit 12:53PM in warding off or avoiding the problem at some reasonable cost.

Q Would, avoiding exposure to a dangerous chemical, be an efficient precaution?

A As I said, it depends on the relative 12:54PM magnitude of the benefits and the costs.

Q Okay. Okay. Fair enough.

Let me -- if all you had to do to avoid exposure to a dangerous chemical was to take a different route home, same amount of time, would 12:54PM that be an efficient precaution?

A Assuming that the benefits of doing so exceed the costs, the answer is yes.

Q Are you -- shifting gears here completely, are you a smoker? 12:55PM

A No.

Q Have you ever been a smoker?

A Long time ago.

Q Did you quit?

A Yes. 12:55PM

Q In your view, did the benefits of quitting 12:55PM

smoking exceed the costs?

A Yes.

Q So in your view, quitting smoking is an efficient precaution? 12:55PM

A Well, it was for me, but this is all subjective. You know, different people attach different benefits to smoking. The costs of quitting are different for different people, so there's not a single answer for everybody. 12:55PM

Q Do you know whether the plaintiff in this case derives any benefits from smoking?

A I don't know anything about this particular plaintiff.

Q I take it, then, you don't know whether 12:56PM she's ever tried to quit.

A I don't know anything about that.

Q Okay. Should a smoker who smokes, knowing the risks of smoking, be permitted to recover punitive damages, using your analysis? 12:56PM

A Well, go back to our contract discussion before. Has the smoker been induced to smoke on the basis of false information? Because, if so, the consumer's perception of what the costs and benefits are, are going to be skewed. 12:56PM

Q How so? 12:56PM

A Because the smoker won't know what the costs are.

Q If the smoker smokes knowing that he may contract lung cancer or emphysema or any number of 12:57PM other dangerous diseases, is that smoker -- should punitive damages be awarded to that smoker?

MR. PIUZE: That's sort of a grossly

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

incomplete hypothetical. That's a grossly incomplete hypothetical. I'll object to the form of the question and invite an answer if the witness can answer.

THE WITNESS: You're saying answer?

MR. STOEVER: If you can answer, yes.

MR. PIUZE: Yeah. 12:57PM

THE WITNESS: Could I have the question read back?

(The question was read as follows:)

"Q If the smoker smokes knowing that he may contract lung cancer or 12:58PM emphysema or any number of other dangerous diseases, is that smoker -- should punitive damages be awarded to that smoker?"

THE WITNESS: There's a lot that goes into 12:58PM what the perceived costs and benefits in any 12:58PM

situation are. I mean in your hypothetical, you haven't told me what the risk is, what the perceived risk is. That's an extremely important aspect of determining what the cost is. And if the smoker has 12:58PM been misled, and, therefore, isn't making the calculation appropriately, then yes, that would be a basis for punitive damages.

BY MR. STOEVER:

Q So if the smoker is misled, then that's 12:58PM the basis for punitive damages?

A I'm not saying it's the basis. It's a basis.

Q It's a basis.

If the smoker is misled, if the smoker 12:58PM starts smoking, after being misled, but subsequently learns that smoking is dangerous and will cause -- well, that smoking is dangerous -- is that smoker entitled to punitive damages?

MR. PIUZE: It's still an incomplete 12:59PM hypothetical and object to the form of the question and, again, invite an answer.

THE WITNESS: Much of what I said before is applicable here. You're not telling me what the risks are, how big they are, et cetera. But the key 12:59PM point, once again, would be what has happened to the 12:59PM

smoker as a result of having been lied to. And if the decision to continue is still a result of the being lied to, then the case for punitive damages remains. 12:59PM

BY MR. STOEVER:

Q What if the decision to continue is a result of enjoying smoking?

A Well, talking about enjoyment, you're only talking about the benefits. I can't answer the 1:00PM question unless -- we still got in our hypothetical, as I got it, we still have the misrepresentation as to what the costs are. So the fact there are benefits doesn't enable me to give you an answer.

Q There's a misrepresentation about the 1:00PM costs --

A Right.

Q -- which the smoker subsequently learns is a misrepresentation, so the smoker knows the actual

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

cost. 1:00PM
A Okay. But if --
Q At that point, if the smoker chooses to continue smoking, is the cigarette company liable for punitive damages?
MR. PIUZE: That's still an incomplete hypothetical. I'm going to object to the form of 1:00PM

120

the question again. Invite an answer again.
THE WITNESS: I'll just repeat what I said before. If the decision to continue -- phase 2 of the hypothetical, if you will, is the result of the misrepresentations made in phase 1, then the case for punitive damages is unchanged.
BY MR. STOEVER:
Q But if the decision to continue is not based on the misrepresentations in phase 1, then the case for punitive damages has changed, correct?
A I'm having trouble understanding.
We now have the correct information. Whatever the source of the problem was before, it's now been corrected, and the smoker knows that the costs are higher than had been thought before.
If you're telling me to assume away any causal link between the first set of misrepresentations and the decision to continue smoking, then the punitive damages would at least be limited, according to what we're talking about here, to the phase when the result of the misrepresentation was -- excuse me -- to the phase when the accurate information had not been imparted and, therefore, the smoking was on the basis of the misrepresentation. 1:02PM

121

Q Okay. Is it your opinion that the plaintiff and defendant in this case have engaged in a transaction?
A Well, you'll have to define "transaction."
Q Well, you used the term in your article. I'm using it as you did.
A In our model, there are only two people. In your hypothetical, you've introduced a third person. You have got a manufacturer, a retailer and --
Q I'm shifting gears from the hypothetical now.
A Oh.
Q Shifting gears from the hypothetical.
In your opinion, have the plaintiff and defendant in this case engaged in a transaction?
A Well, how are you defining "transaction"?
Q I'm using it as you do in your article.
A In our article, one person buys directly from another. If you're asking is that the same kind of thing as we have with a purchaser of cigarettes who buys from a manufacturer through an intermediary, it's not the same transaction as in here. It's a different transaction.
Q In your opinion, was there information

122

imparted by the defendant to the plaintiff, in this case information about cigarettes, imparted by the plaintiff -- by the defendant to the plaintiff in

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

this case? 1:03PM
A It's my understanding that part of the basis for this lawsuit is information that the manufacturer put out that was -- or that the plaintiff or Ms. Bullock became aware of.
Q And you've not gone out to do any kind of independent assessment whether or not that has -- that did, in fact, occur, correct? 1:03PM
A That is correct.
Q And it's not your -- and your only assessment of whether that did, in fact, occur is going to be based on the record at trial in this case, correct? 1:04PM
A That is absolutely correct.
Q Earlier when we were talking about the mine hypothetical, you asked me whether or not the employers had an obligation to tell the employees.
Picking up on that, does Philip Morris have an obligation to tell smokers about the risks inherent in cigarettes? 1:04PM
A I don't know that the obligation would be a legal one, and I don't know what the law would be 1:04PM

in that respect.
Q So you don't have any opinion one way or the other on that?
A I do not. 1:04PM
Q Do you have an opinion as to whether Philip Morris owes society generally a duty to explain the risks associated with cigarette smoking?
A That's not something anybody has asked me to opine about, no. I have no opinion. 1:05PM
Q In your analysis, are the characteristics of the plaintiff relevant?
A Ordinarily they would not be. Again, this is assuming that liability has been established. I mean so to the extent the characteristics of the 1:05PM
plaintiff are relevant for liability issues, yes, but that's not what we're here to talk about here today, as I understand it.
Are they relevant to the punitive damage consideration? We've talked about some situations 1:05PM
in which they might be, such as eager victims. But for the most part, since what we're talking about in this model is stripping gains from defendants, the characteristics of the plaintiff are not of particular relevance. 1:06PM
MR. STOEVER: Okay. Why don't we go off 1:06PM

the record.
(The luncheon recess was taken at 1:06 p.m.)

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

APPEARANCES OF COUNSEL:
(P.M. SESSION)

THOMAS W. STOEVER, JR., ESQ.

MARK W. MESSENBAUGH, ESQ.

MICHAEL J. PIUZE, ESQ.

REPORTED BY:

LANA L. LOPER, RPR, CRR, CSR No. 9667,
CCR No. 690

(The deposition of FRED S. McCHESNEY, Ph.D. was reconvened at 1:44 p.m.)

FRED S. McCHESNEY, Ph.D.,
the witness, having been previously administered an oath in accordance with CCP Section 2094, testified further as follows:

EXAMINATION (CONTINUING)

BY MR. STOEVER: 1:44PM

Q I want to turn to the concept of making the defendant whole. And I take it from your earlier testimony that that means stripping the defendant of any benefit it received from a socially unacceptable activity. Is that correct? 1:44PM

A Right.

Q If a defendant is a corporation, does that mean -- does that equation amount to returning the profits made by the corporation as a result of the socially unacceptable activity? 1:44PM

A It certainly would include the profits that resulted. I guess I would say hypothetically, in a particular fact situation, there could be other benefits; but certainly for purposes of argument, that would be the obvious place to start when you're 1:44PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

identifying what would be stripped. 1:44PM

Q Okay. Let's -- rather than engaging in an abstract discussion, let's try to put it in the context of this case.

A Okay. 1:45PM

Q Let's assume that the jury finds the facts that Mr. Piuze and others asked you to assume on your conference calls, and you are asked to testify about the appropriate measure for making the defendant, making Philip Morris, whole in this case. 1:45PM

Would that be Philip Morris's profits?

A Again, all I can say is it would include them. I don't know what testimony there might be, what findings there might be, but there are other forms of benefit. And that's not really anything 1:45PM that I'm going to be involved in, as I understand it. It would be something that I would take into account if the factual findings revealed there was something else.

Q So what you're saying is you can't tell me 1:46PM whether it's going to be limited to profits until you review the record in this case?

A That would be a fair summary, yes.

Q Let's assume for the moment that there's nothing in the record beyond what you have been 1:46PM

asked or what Mr. Piuze and Mr. Chesebro told you to 1:46PM assume when they had that first conversation with you.

Would the measure of making Philip Morris whole be Philip Morris's profits? 1:46PM

A I'll put it this way: At the moment, I have not heard of anything that would cause me to say that there would be something other than profits involved --

Q Okay. 1:46PM

A -- if that's a fair enough case.

Q Let's start with that. Let's start with that.

A May -- if I may add one other thing. You say the only thing -- there's a question of what the 1:46PM probabilities of being detected and what have you that would go into that because you're talking about what the expected value of a case like this is -- or excuse me -- expected value to a defendant of engaging in behavior like this. And in figuring out 1:47PM expected values, you have to take into account the likelihood of being apprehended in doing this or not being apprehended in doing this.

But your question, as I understand it, has to do with not with that, but with what the measure 1:47PM

of the benefit, profits versus profits plus 1:47PM something else ought to be.

Q Let's -- just so I'm clear, at this point, you know of nothing that would make the universe of punitive damages something larger than Philip 1:47PM Morris's profits. Is that correct?

A That is correct.

Q Okay. Let's talk about what those profits are. Are you talking about the profits from the sale of all cigarettes by Philip Morris? 1:47PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A I would be talking about the profits due to the activity that justifies the imposition of the punitive damages, the socially undesirable aspect. So if we're talking about, to use an example that we had before, the provision of misrepresentations or false information, call it what you will, deceptive information, that's the activity you want to deter and, therefore, it's the benefits due to that that are of importance; benefits presumably, for the sake of argument in this discussion being or referring to profits. 1:48PM

Q Is it the profits that Philip Morris made on the sale of cigarettes to Betty Bullock as a result of the socially undesirable activity?

A As opposed to? 1:48PM

130

Q As opposed to the sale of cigarettes to everyone. 1:48PM

A If you -- if you're working with the notion of optimal deterrence, what you would like to do is strip away the gains from the socially undesirable activity to everyone. 1:49PM

Now, I don't know what the legal rules are as to whether or not -- or to what extent gains realized at the expense of other potential plaintiffs other than Ms. Bullock, whether those can be recovered or not in this case. From a strictly economic standpoint, you would like to be sure that all the gains from the undesirable activity are disgorged. 1:49PM

Q So in this case, if the jury finds that Betty Bullock was misled, it would be your opinion that the jury should make Philip Morris whole by stripping away all of the benefits Philip Morris received from misleading anyone about the risks of smoking. Is that correct? 1:49PM 1:50PM

A In terms of the economics of deterrence talked about here, the answer is yes. But, again, I'm not functioning in this case as a lawyer, just as an economist. There may be legal constraints on that; and, of course, if those are the constraints, 1:50PM

131

those are the constraints. But yes, the goal, economically, is to strip away all the gains. 1:50PM

Q And is it your opinion that everyone who smokes does so as a product of misrepresentation by Philip Morris? 1:50PM

A I don't have any basis as I sit here today for making that statement.

Q How are you going to determine the profits that Philip Morris makes from the sale of cigarettes to people who are not misled versus the profits Philip Morris makes from the sale of cigarettes to people who are misled? 1:51PM

A I don't understand that to be part of what I'm being asked to render an opinion on.

Q Well, if you're going to suggest the jury measure punitive damages by looking at the profits Philip Morris made from the socially undesirable activity, how are you going to segregate those profits from all of the profits Philip Morris makes from the sale of cigarettes? 1:51PM 1:51PM

A Well, you would have to have whoever is

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

going to undertake that exercise, assuming it is undertaken, you would have to use the techniques that advertisers use to determine the extent to which people are getting their message and acting on it. 1:51PM

Q Are you going to do any kind of work along those lines?

A Not as I understand my assignment today, no. 1:51PM

Q So you're not going to offer any opinions about what percentage of Philip Morris's profits may be the result of socially undesirable activity?

A I would offer no independent opinion. It may well be there's something in the factual findings that would go to that, in which case as part of my testimony about how you would think about this, that could be a relevant fact, but it would come out of something that somebody else does. 1:52PM

Q Do you have any opinion as to how many smokers have been misled by Philip Morris? 1:52PM

A No.

Q What's the time frame for the profits that you would see disgorged as a result of making the defendant whole? 1:53PM

A Well, it would be the period of time over which the undesirable activity took place, plus whatever -- whatever activity subsequently was also a result of the undesirable activity. Advertising has affects that persist beyond the period of the ad, for example; and this is something that is well understood in both the marketing and economic literature. So if you were looking at the effects of an ad as advertisers do, they don't just look at the effects during the time the ad ran, so there is that effect, for example. 1:53PM

Q So the period of time would begin whenever the jury determines Philip Morris began, assuming the jury determines Philip Morris began, misrepresenting its product, correct? 1:53PM

A Yes, I would expect that to be the case.

Q You're not going to make any independent determination about when Philip Morris began misrepresenting its product?

A No. 1:54PM

Q And it would run through the period that the jury determines Philip Morris no longer is misrepresenting its product?

A It could. It's a factual question, how long the effects of the misrepresentation persisted, because we're talking about the gains from the undesirable activity. The gains probably persisted beyond the period of the misrepresentation. 1:54PM

Q But that's a factual question that you're going to leave to the jury to determine? 1:54PM

A That's correct. 1:54PM

Q You're not going to undertake any independent review of that issue?

A No, I'm not.

Q Just so I'm clear, the benefit that Philip Morris received would be the profits as a result of 1:55PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Philip Morris's misconduct, correct?
A I've heard mention of no other benefits than profits.
Q So at this point, your conclusion is that the benefit Philip Morris received is the profit from the sale of cigarettes resulting from socially undesirable activity? 1:55PM
A That is correct.
Q And to make Philip Morris whole, you would want to strip away the benefit Philip Morris received from that socially undesirable activity? 1:55PM
A That is correct.
Q But you don't know what percentage of Philip Morris's profit is the result of that socially undesirable activity? 1:55PM
A Correct.
Q You don't know whether there are smokers who smoke knowing the risks of smoking?
A That is correct. 1:56PM

Q You don't know whether there are smokers whose decision to smoke has nothing whatsoever to do with any socially undesirable activity the jury may find Philip Morris engaged in? 1:56PM
A That's correct. I have no information about that. 1:56PM
Q In your method of analysis, if the plaintiff receives -- this is a hypothetical now -- if the plaintiff receives compensatory damages that are greater than the benefit the defendant received from the socially undesirable conduct, is there a basis for awarding punitive damages? 1:56PM
A If the gains to the plaintiff -- I'm sorry. If the gains to the defendant exceed the losses to the plaintiff so that -- 1:57PM
Q No. No. You got it backwards.
A I'm sorry.
Q That's okay. That's okay. Let me try it again.
If the compensatory damages -- 1:57PM
A Okay.
Q -- exceed the gains to the defendant from the socially undesirable conduct so that the defendant is paying in compensatory damages more than it received in the form of gain from the 1:57PM

socially undesirable conduct, is there a basis for awarding punitive damages? 1:57PM
A So in your hypothetical, the defendant is stripped of all the expected gains from this socially undesirable activity by the payment of the compensatory damages themselves? 1:57PM
Q Yes, sir.
A The purpose of imposing punitive damages in the ordinary case has already been realized in your hypothetical by the payment of compensatory damages to the plaintiff, and so the answer would be no. 1:58PM
Q So -- okay. Withdraw that.
In your analysis, do you -- you take into account all of the benefits received by the defendant in the -- as a result of the socially undesirable activity, correct? 1:58PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A Correct.
Q Do you also account for any benefits that the defendant might give rendered to society as a result of the socially undesirable conduct? 1:58PM
A Well, it seems to me there's an internal contradiction to your question. If it's socially undesirable, meaning its optimal rate is zero, then there wouldn't be any benefits. If it's costly, but 1:59PM

137

there are also benefits, then we're not talking about an activity whose optimal rate of benefit is zero. 1:59PM
Q Let's try to put it in concrete terms, then. Let's assume the jury finds Philip Morris misled Mrs. Bullock. 1:59PM
A Okay.
Q Over the years Mrs. Bullock has been smoking, Philip Morris has employed a large number of people. And if I understand your theory of Philip Morris, Philip Morris did, in fact, mislead Mrs. Bullock. 1:59PM
In order to make Philip Morris whole, you would have to strip not only the profits it made on sales to Mrs. Bullock, but the profits made on sales to everyone who purchased cigarettes as a result of being misled by Philip Morris? 1:59PM
A And the answer is yes, with the stipulation that there are -- there are perhaps other plaintiffs and what have you. And consequently, it may be that through not just the one lawsuit, but through three lawsuits, let's say, all based on this misleading statement, that Philip Morris ultimately has its gains taken away from them. 2:00PM 2:01PM

138

Q Once Philip Morris's gains from the sale of cigarettes to people who bought them because they were misled have been taken away, there is no further basis for assessing punitive damages against Philip Morris, correct? 2:01PM
A In terms of the economic rationale for deterrence that is set out here, that is a correct statement. 2:01PM
Q Are you going to do any analysis to determine whether or not punitive damage awards already assessed against Philip Morris have, in fact, stripped away any benefit Philip Morris received from the sale of cigarettes as a result of sales misleading the public? 2:01PM
A No, I have not been asked to do that. 2:01PM
Q Isn't that relevant to your opinion?
MR. PIUZE: You're assuming facts not in evidence. And although I will butt out of your deposition to the greatest extent, Philip Morris brags publicly about the fact it has never paid any money. 2:02PM
THE WITNESS: It's not relevant to this. As long as the gains are stripped away, then what is being discussed here in terms of optimum occurrence works, no matter if it's stripped away in one case, 2:02PM

139

four cases. 2:02PM
BY MR. STOEVER:

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Are you going to tell the jury, in coming to a conclusion, it should consider whether Philip Morris's gains have been stripped away by other punitive damage awards? 2:02PM

A We talked about before how it doesn't matter if the punitive amount is greater than the amount of the gain from the undesirable activity as long as it is at a minimum at that level. Greater punitive damages don't have any affect on the level of the activity still going on. By hypothesis, that level is zero. 2:02PM

Q But don't greater punitive damages punish Philip Morris more than is necessary? 2:03PM

A They may punish -- I think we have talked about this already. They may punish Philip Morris more than -- by "necessary," if by "necessary" we mean the minimum amount to force disgorgement of all the gains, but it doesn't matter in terms of deterrence as long as the minimum level of disgorgement is reached. 2:03PM

Q Maybe I asked you this earlier. Is there such a thing as over-deterrence?

A If by "over-deterrence" you mean is it 2:03PM

possible that a jury would impose greater punitive damages than the amount necessary to achieve optimal deterrence, the answer would have to be yes. 2:03PM

Q Are there adverse consequences as a result of over-deterrence? 2:03PM

A Not in terms in deterring or, excuse me, not in terms of reaching the optimal level of activity, which is what we're talking about in this article.

Q Would there be adverse consequences for Philip Morris as a result of over-deterrence? 2:04PM

A By definition, they're paying more than they otherwise would pay.

Q Are they paying more than they should have to pay? 2:04PM

A I don't know what "should have to pay" means.

Q In your world, "should have to pay" is the amount necessary to strip away any benefit Philip Morris received? 2:04PM

A It's at a minimum that amount. There is no -- in this approach, there is no problem associated with paying more than the minimum amount.

Q So in your view, there's no maximum amount of punitive damages? 2:04PM

A Not coming out of this model of optimal deterrence, no. We've talked about a few exceptions. Again, we talked about eager victims, but you haven't assumed that in the context of that particular question. 2:04PM 2:05PM

Q Right. And actually, in the context of eager victims, there's no maximum amount of punitive damages; the only question there is who gets the money, right?

A That's correct. 2:05PM

Q So even when there's an eager victim, no maximum of punitive damages; only question, does it go to the plaintiff or does it go to the state.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A Or some other third party, right. Right.
Q If Philip Morris were to be -- if the jury were to award punitive damages in an amount greater than what was necessary to strip away any benefit that Philip Morris received, that would have adverse consequences for Philip Morris's shareholders, correct? 2:05PM
A Yes.
Q It would have adverse consequences for Philip Morris employees, correct?
A We talked about this before. I'm not sure how the effects would translate themselves down the chain. It is certainly a possibility. 2:05PM

Q It's a likelihood, isn't it?
A Well, I don't know.
Q If Philip Morris was to have to pay more than it should to strip away the benefit from undesirable social activities, it's likely to hurt Philip Morris's employees, isn't it? 2:06PM
A Not necessarily. I'm willing to grant that it's a possibility. But suppose you took away $100 million from Microsoft today. How would that affect Microsoft tomorrow? I don't think it would affect them a bit. Would they stop making what they're making, make less of what they're making? I don't think so. 2:06PM
Q You haven't done any determination -- excuse me -- investigation determining how taking $100 million away from Philip Morris may affect their operations, have you?
A No, I have not.
Q Do you intend to do any such investigation? 2:06PM
A No.
Q I want to go back to a concept we discussed earlier this morning, eradication.
When you talk about eradication, you're talking about eradicating the socially undesirable activity, correct? 2:07PM

A That is correct.
Q You're not talking about eradicating the defendant? 2:07PM
A No.
Q So you're not going to -- well, let me rephrase that.
Are you going to -- withdraw that.
Is it your opinion that punitive damages should be awarded -- is there any case in which punitive damages should be awarded in an amount necessary to bankrupt a company? 2:07PM
A Hypothetically, I suppose if for whatever reason it was thought that the company wasn't going to get the message and was going to go right back out and doing the objectionable things, that would be a possibility. But the whole discussion we have been having about punitive damages is based on punitive damages sufficient to deter the objectionable conduct. 2:07PM
Now, if the only way to deter continued episodes of the objectionable conduct is to bankrupt the company, throw it into Chapter 7 or something, 2:08PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

well, that would fit the model. But lacking -- or excuse me -- thinking along those lines really requires you to predict the future; is this going to continue despite the imposition of the damages. And I guess hypothetically there could be pieces of paper that said, "We don't care whatever happens in this litigation. We're going to keep on doing what we're doing. They can do whatever they want to us. We don't care."

Q Isn't one consequence of the notion there's no maximum level of punitive damages under your model the possibility that punitive damages will be awarded in an amount that would bankrupt a company?

A Well, as a strictly logical matter, yes.

Q Will you offer the opinion to the jury that it should award punitive damages in an amount that would bankrupt Philip Morris?

A As I sit here now, I have no basis for making -- or for testifying along those lines, no.

Q Is it your opinion that Philip Morris should be put out of business?

A No, that's not my opinion, again, assuming there's no reason to think that putting the company out of business is the only way to get this objectionable behavior to stop. I'm assuming you're

not asking me to make that assumption.

Q No, I'm not.

And again, I want to be sure I understand sort of the parameters, using your model, the minimum amount of punitive damages that should be awarded is the amount that is necessary to deter the defendant from engaging in the socially undesirable activity again. And in your view, that is the amount that strips the defendant of any benefit from the socially undesirable activity, correct?

A I think it's correct, but let me try to state it somewhat differently.

It's the amount that strips away the past gains which in a system, a legal system such as ours, sends the message that this is what is going to happen next time if anybody else does these kinds of things.

Q And that's the minimum amount?

A That's correct.

Q And with that modification, what I said previously accurately describes your model?

A I believe it does.

Q And that's on the minimum side.

On the maximum side, there is no maximum amount of punitive damages?

A Nothing in what is being talked about here that goes to this issue of maximums, maxima. It's focused on explaining why it is -- why you might, as an economic matter, want punitive damages. And the implication of this is that you want to have something that at least represents an amount that takes away the gains. Beyond that, there's no -- there's little discussion in this paper about this. And as I said before, from the standpoint of optimal

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

deterrence, it doesn't matter. 2:11PM
Q Is your -- your model, your method of analysis, does not account for -- or let me rephrase that -- does not suggest that the jury should award punitive damages on the basis of any sort of moral outrage, correct? 2:12PM
A That is correct.
Q That would not be something you would offer an opinion on at trial?
A That is correct. As an economist, I have nothing to say about that. 2:12PM
Q Again, to make sure I understand, let's assume that three people have purchased cigarettes, have started smoking and bought cigarettes as a result of -- because they were misled by Philip Morris. Okay? 2:13PM

A Right. 2:13PM
Q The first person sues, and the jury awards punitive damages in an amount that would take away all the profits that Philip Morris made from the sale of cigarettes to those three people. Okay? 2:13PM
You with me so far?
A Right.
So all the gains from the fraudulent statement are taken away by the punitive damages awarded to plaintiff A? 2:13PM
Q Correct.
Plaintiff B sues. Should -- is plaintiff B entitled to punitive damages?
A Well, what B is entitled to is a legal question. In terms of what I'm talking about here 2:13PM
is a matter of economics. Optimal deterrence has been achieved by hypotheses in the suit brought by plaintiff A.
Again, if further punitive damages are imposed, then we have got punitive damages that are 2:14PM
in excess of the gain to the defendant, and it is just of no consequence one way or another in terms of the deterrence-based analysis that we're using here.
Q Okay. Is there any economic analysis in 2:14PM

which it is a matter of consequence whether Philip 2:14PM
Morris is punished in an amount that exceeds the gains?
A None that I'm aware of.
Q So it's possible that Philip Morris would 2:14PM
be penalized twice for the same conduct?
A Again, I don't know what the law is. If the law allows recovery -- or recovery of punitive damages by B after all the gains have been disgorged
in the suit brought by plaintiff A, then yes, by 2:14PM
definition, the law must allow it; otherwise, B wouldn't have got it. But I can't answer your question.
Q Well, let's assume that the law doesn't speak to this issue and that the jury is being 2:15PM
guided only by your method of analysis. Under your method of analysis, you would tell the jury in the suit brought by plaintiff B, "If you want to, go ahead and award punitive damages"?
A I would say, "In terms of the optimal 2:15PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

deterrence that explains the reasons for punitive damages, that's already been done in suit A, or the suit brought by plaintiff A."

Q Would you also say, "If you want to" -- "But if you want to, go ahead and award punitive damages"? 2:15PM

A I wouldn't have any basis for saying that.

Q Let's run another hypothetical. Let's assume that ten people bring lawsuits against Philip Morris. 2:16PM

A Okay.

Q And they all make the same allegations; that they started smoking because they were misled and now they're sick.

A Okay. 2:16PM

Q In the first nine lawsuits, either the cases are dismissed or the juries find for the defendant. In the tenth lawsuit, the jury finds for the plaintiff on the same facts.

In that case, should the jury award punitive damages in an amount necessary to strip away all of the benefits Philip Morris received from the sale of cigarettes to all ten plaintiffs? 2:16PM

A I would have to think about that because what you're saying is that, in effect, if you take all these results and accumulate them, it's not clear whether, on the same set of facts, this socially undesirable conduct caused people to do something different or whatever it might be.

I guess all I can say at this point is 2:17PM

what we've worked with here assumes that it's clear whether the conduct has occurred or not and whether the conduct is the kind that ought to be deterred through the use of punitive damages because it is something that has no redeeming social value. 2:17PM

How you would handle that kind of situation, I would just have to think about it. I have never been confronted with it.

Q Are you aware whether Philip Morris has ever been -- whether a jury has ever entered a defense verdict in a case making the same allegations that Mrs. Bullock makes? 2:17PM

A I'm not aware of anything.

Q Given your answer to my hypothetical question, wouldn't that be relevant to your inquiry? 2:18PM

A It might. I would just have to think about it, as I say. It was not something that I was asked to assume was the case. I don't know that it is the case. I was simply asked to assume in this particular case it would be shown the objectionable behavior occurred. 2:18PM

Q Okay. But even if it's shown -- going back to the hypothetical, even if the jury determines that the behavior was objectionable in the tenth case, you still have nine other juries that found the behavior wasn't objectionable, and that would give you some reason to pause and think about whether or not punitive damages should be awarded in the tenth case, correct? 2:18PM

MR. PIUZE: Let me interject for a second. 2:18PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

I think the question changed a little bit. The fact you got a hypothetical defense verdict in the other cases doesn't mean the conduct wasn't objectionable. Are you asking him to assume that the jury made a finding that the conduct wasn't objectionable?

MR. STOEVER: All I'm asking him to do is to assume the jury rendered a defense verdict.

THE WITNESS: Oh, I see. But we don't know the reason why. 2:19PM

BY MR. STOEVER:

Q The jury heard all the facts. They heard all the testimony, all the same facts and same testimony heard in the tenth case, and the jury reached the conclusion that Philip Morris was not liable. 2:19PM

A But it could have been not liable for reasons having to do -- nothing to do with the undesirable conduct?

Q No. 2:19PM

A Could have been statute of limitations? 2:19PM

Q No. No. All the facts are the same. All the facts in all the ten cases are the same.

A Right. But in the cases where there's a verdict for the defense, we don't know on what basis. You're saying it could be any basis? 2:19PM

Q Could be any basis.

A Right.

Well, in that case, then we still have the undesirable conduct we would want to deter, and that would certainly alter my evaluation of the appropriate -- or the way to think about optimal deterrence in the tenth case. 2:20PM

Q So let me -- how would it alter your evaluation of the appropriate way to think about optimal deterrence in the tenth case? 2:20PM

A I thought you were proposing a hypothetical in which nine juries had found on the basis of lack of socially undesirable conduct that the defendant won. But now I understand you to be saying all we know is the defendant won; we don't know why. 2:20PM

Q Okay.

A So you're left with the finding in the tenth case, where by hypotheses, if I understand 2:20PM

your hypothetical, the jury does come back and finds that this socially undesirable conduct did occur and it affected the plaintiff in that particular case. So now we don't have a -- we don't the same sort of murkiness about whether or not this conduct really did occur or not. We have only one finding by one jury that specifically -- or excuse me. We have only one decision by a jury specifically finding that this undesirable conduct occurred. 2:20PM 2:21PM

Q Let me try to clarify my hypothetical. 2:21PM

In the first case -- well, in the first place, we know that the conduct occurred. The question really is whether it's socially undesirable or not, correct?

A That's possible, yeah. The advertising occurred by hypotheses. We don't know whether it's 2:21PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

true or false.
Q The advertising occurred. The only question is whether or not it was socially undesirable or not. 2:21PM
A Whether it was fraudulent or not?
Q Just to be clear, if a jury finds in case A that that advertising was not socially undesirable and, therefore, the plaintiff can't base a claim for liability on it and a jury finds in 2:22PM

154

case B the opposite, then you would need to think about how you would deal with that situation, correct? 2:22PM
A That's exactly right.
Q But if the jury in case A only said -- you know, said nothing more than that we find for the defense -- 2:22PM
A Yeah. That doesn't provide us much information about whether we have the sort of conduct that ought to be deterred -- 2:22PM
Q But doesn't that --
A -- by punitive damages.
Q Doesn't that suggest, the jury found there was no undesirable conduct in case A, that alone, that was no socially undesirable conduct? 2:23PM
A No. There's a number that go into liability; that's only one. Could have been something else that caused them to -- in my example, in response to your earlier question -- I mean maybe it's a statute of limitations. 2:23PM
Q Let's assume it's not statute of limitations. Let's assume that -- well, withdraw that. Okay.
Does your method of analysis take into account the prospect that the defendant might have 2:23PM

155

liability to other plaintiffs who would go uncompensated if the award of punitive damages is too large? 2:23PM
A No.
Q Is that relevant to your analysis? 2:24PM
A No, it's not. The analysis simply focuses on stripping the gains. It doesn't have to do with who's going to get the gains.
It's the same situation as we talked about before, when we talk about giving the punitive damages to the government. It's really not of particular relevance in the ordinary case we're describing here. 2:24PM
Q Okay. Let's shift gears for a minute and talk about deterrence. 2:24PM
If I understand you correctly, if I understand your testimony correctly, deterrence turns on the likelihood that a defendant will get caught engaging in tortious conduct in the future. Is that correct? 2:25PM
A Well, one factor in the -- in defendant's expected gains is the likelihood of being apprehended.
Q And where the defendant is less likely to be caught, the amount of deterrence needs to be 2:25PM

156

larger? 2:25PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

A That's correct, all other things equal.
Q And all other things being equal, where the defendant is more likely to be caught, the amount of deterrence is smaller? 2:25PM
A The amount of the punitive damages would be smaller to reflect the higher probability of being caught.
Q And that would be being caught in the future, correct? 2:25PM
A Well, your -- no, that's not correct. You're focusing on the expected gains to the defendant from committing the particular activity, which is the subject of the suit, the socially undesirable conduct that goes into the activity that 2:25PM is the subject of the suit.
The expected gain to the defendant includes the probability of being apprehended. As the probability of being apprehended goes up, the expected gain goes down. So the amount, the minimum 2:26PM amount necessary in terms of punitive damages, if they are appropriate at all, is a function of the before-the-fact probability of being apprehended.
Now -- I'll just leave it at that.
Q Does your model assume that the defendant 2:26PM

is engaging in the objectionable conduct at the time 2:26PM the suit is brought?
A No, it doesn't assume anything one way or the other about that.
Q What are some of the factors that affect 2:27PM probability of detection?
A Well, there you would probably want to turn to some of the literature, criminal law literature and what have you; how open it is, obviously; how many people are involved. The more 2:27PM people you have involved, the more likely it is to get out, the easier it is for people to perceive the truth; i.e., whether it's a matter that is relatively easy to find out about or whether it's to use an opposite, scientific information about which 2:27PM people are really not very well -- or not very knowledgeable and would find it more difficult to learn the truth. There's no -- I don't think there's any sort of template for answering that question. It's relatively fact specific to each 2:27PM situation.
Q Has it been relatively easy to find out about the health consequences of smoking for some time?
A Perhaps. 2:28PM

Q Do you know? 2:28PM
A I don't.
Q Why did you quit smoking?
A Just didn't like it. Dirty.
Q Were you worried about the health 2:28PM consequences?
A I don't think that had a whole lot to do with it. I imagine it's something I thought about. I was in my 20s. It didn't matter a whole lot.
Q How long ago was that? 2:28PM
A Thirty years ago -- 25 years ago.
(Interruption and messenger

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

entered.)
BY MR. STOEVER:
Q Is it your view that today it's relatively easy to find out about the health consequences of smoking? 2:28PM
A It's my view it's easier -- by "relatively easy," if you mean easier than it used to be, the answer would be yes. 2:28PM
Q How long has it been relatively easy to find out about the health consequences about that?
A I don't know anything about that.
Q Do government oversight and regulation increase the probability of detection? 2:29PM

159

A It might. 2:29PM
Q Does scrutiny from private organizations increase the probability of detection?
A It might.
Q Do lawsuits increase the probability of detection? 2:29PM
A It might.
Q If a defendant is no longer engaged in the socially objectionable conduct that the jury bases liability on, does that defendant need to be deterred? 2:29PM
A The point again is to strip away the expected gains from the activity at the time the activity was committed. And consequently, because it's a system precedent, the point is to send the message to anyone else who might be considering such behavior, that the gains from doing so will be stripped away. So the fact that it's not likely that it's not going to continue in the future wouldn't have any impact on whether or not punitive damages were appropriate on the basis of past conduct. 2:29PM 2:30PM
Q Why is the point of reference the probability of detection at the time the conduct was engaged in? 2:30PM

160

A Because you want to deter it. If you make it clear before the activity begins that there's no return from doing it, then it won't occur and you'll maintain the optimal level of that activity, which is zero. 2:30PM 2:30PM
Q Why can't you deter it by assessing the probability of detection at the time punitive damages are awarded?
A Because I don't even understand what -- how you would do that. I don't understand how this fits into any model of optimal deterrence. That just allows people to keep the past gains from their activity. That's not -- that's not what we want at all. 2:30PM
If your point was, well, there's no chance of getting away with it anymore because now everybody knows about it, that just means that all activities out there, which today are profitable but which may not be tomorrow, shouldn't be the basis of any punitive damages, and so the incentive remains to commit the objectionable acts at the time, so they do get committed, and you don't have your optimal level of deterrence. 2:31PM 2:31PM

http://legacy.library.ucsf.edu/tid/suc07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Is there any literature that you can refer me to on this subject? 2:31PM

161

A Well, on which subject specifically? 2:31PM
Q On the issue of the point of reference or the time reference for probability of detection.
A Other than the, to me, rather common sense notion, if you are trying to strip away the gains in 2:32PM advance or make it unattractive in advance to commit the activity in the first place, no, I can't think of any literature.
What you're proposing just deflects the entire purpose of deterring the activity in the 2:32PM first place.
Q Well, if a defendant knows that it's going to have -- let me rephrase that.
If a party knows that if it engages in a socially undesirable activity it will have the 2:32PM benefits of that activity stripped away, what -- at the time punitive damages are awarded, what difference does it make that the probability of detection is at the moment the activity is engaged in? 2:33PM
A Because there's a big difference between paying punitive damages with a one percent probability of being caught and paying punitive damages at 100 hundred percent probability of being caught. 2:33PM

162

Q How so? Pardon me. How so? 2:33PM
A If you think there's only a one percent chance you'll be caught, the benefits from undertaking the activity are much greater; you're very unlikely to ever end up in court and ever pay 2:33PM any punitive damages. If it's a 100 percent probability of being caught then, by definition, it's a certainty you'll end up in court and will pay punitive damages on this deterrence model. The decisions look quite different to the decision-maker 2:33PM at the time when you change the probabilities of ever having to pay punitive damages in the first place.
Q Are you going to offer any opinions about the probability of detection that -- well, I'm 2:34PM sorry. Let me withdraw that.
I take it that the equation, the probability of detection equation, is one that the corporation engages in before it engages in the conduct. Is that your view? 2:34PM
A It's a factor that would be relevant in deciding what the expected benefits from undertaking the activity are.
Q Are you going to offer any opinions about what the probability of detection was for any 2:34PM

163

activities that Philip Morris may have undertaken in 2:34PM this case?
A Are you asking whether I'll offer an opinion as to whether the number was X versus Y?
Q Yes. 2:34PM
A No.
Q Are you going to offer any opinion whether the probability of detection was high versus low?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A I don't even know what those terms mean. Those are relative terms. 2:34PM
Q Are you going to offer any opinions as to whether managers or executives at Philip Morris considered the probability of detection before engaging in any activities?
A If there was a finding to that effect and someone asked me to talk about its relevance, I could do that, but I don't know whether that's -- whether that assumption is even true, to begin with. 2:35PM
Q Let's say that the jury finds the fact that Mr. Piuze asked you to assume in that first phone call. 2:35PM
A Okay.
Q How is the probability of detection relevant to your analysis at that point?
A It's relevant in that to achieve optimal 2:35PM

deterrence one has to strip away all the expected gains from the activity. And the probability of being apprehended and having to pay punitive damages is one of the things that affects the expected benefits of the activity and, therefore, affects the 2:35PM 2:36PM amount of punitive damages that would deter the activity.
Q In this case, are you going to do any kind of independent determination about what the probability of detection was for Philip Morris? 2:36PM
A Again, I'll say -- are you asking me am I going to say that it was X as opposed to Y?
Q Well, it sounds to me like it's one of the factors you're going to suggest to the jury, the jury should consider when awarding punitive damages. 2:36PM
A I would -- yes, I would say that this is a factor that is relevant since we want to strip away the expected gains; and the expected gains are, by definition, a function of the probability.
Q Are you going to suggest to the jury what it should look at to determine what the probability of detection was? 2:36PM
A You mean what specific documents or --
Q Any specific document. Let's just say anything. Are you going to tell the jury what it 2:37PM

should consider when assessing what the probability of detection was? 2:37PM
A Well, that's -- the probability is a question of fact. They would consider whatever evidence there is that bears on that particular fact. 2:37PM
Q So you -- at this point, based on what you know about this case, do you have any understanding of what the probability of detection was at any time for Philip Morris? 2:37PM
A Not -- if you're, again, asking me about a number, the answer is no.
Q Do you have any -- I'm asking now not for a specific number, but just asking whether you know whether the probability of detection was high or low. 2:37PM
A What's "high"?
Q At any time was the probability of detection for Philip Morris greater than 50 percent?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A I don't know what a number is. That's the problem I'm having with the question. If I don't have a number, then I can't tell you whether it was high or low. 2:38PM

Q What I'm trying to understand is how probability of detection -- what you're going to say 2:38PM

166

about probability of detection to the jury. Let me just ask that. 2:38PM

What will you tell the jury about probability of detection?

A That as the facts support a finding that the probability was -- and I'll say relatively high or relatively low -- then this is a factor that they should consider; that at least in terms of this model of deterrence that we have been talking about, this is a factor of relevance in deciding what the amount of the expected gains were that ought to be disgorged. 2:38PM

Q And --

A But it's their province to find the fact, not mine, as I understand the way this works. 2:38PM

Q If the defendant is no longer able to engage in the objectionable conduct, does that affect the amount of deterrence necessary?

A It wouldn't affect the amount of deterrence necessary to strip away the past gains. 2:39PM

Q Does it affect the amount of deterrence in any way?

A Well, we talked before about supposed hypothetically that it seemed quite clear that the defendant was going to go out and do just the same 2:39PM

167

thing all over again. You know, would you make an adjustment for that reason? I don't know. I haven't seen anything that -- to suggest that's an issue in this particular case. And -- but what you're -- what you want to do is to make these things so unprofitable that they never occur. And so the fact that it's not going to occur again in the future doesn't take away from the fact it did occur in the past. And if everybody had the incentive to just do it one time and then somehow tie itself to the mast and make it clear that this would never happen again, then we would have a lot of people out there who commit one murder, one rape, and that's not the point. We want zero murders and we want zero rapes. 2:39PM 2:39PM 2:40PM 2:40PM

Q In your mind, I mean there's a difference between civil and criminal, right?

A Right.

Q And this is a civil case, right?

A But we're talking about socially undesirable conduct. In that sense it cuts across civil and criminal, but I certainly agree with your statement. 2:40PM

Q Does your method of analysis take into account any restrictions that have been imposed on 2:41PM

168

Philip Morris to prevent it from engaging in similar conduct in the future? 2:41PM

A It would be irrelevant under what we have been talking about here.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

(Mr. Piuze exited the room.) 2:41PM
BY MR. STOEVER:
Q Have you looked at any of the steps that Philip Morris has taken to prevent the conduct that is alleged in this case from occurring again?
A No. 2:41PM
Q Have you looked at the terms of the master settlement agreement between Philip Morris and the attorney general?
A No.
(Mr. Piuze entered the room. The messenger exited the room.) 2:41PM
BY MR. STOEVER:
Q Are the restrictions contained in the master settlement agreement relevant to your analysis? 2:41PM
A Since I don't know what they are, I don't know how to answer your question.
Q Okay. Are restrictions on Philip Morris's ability to engage in the conduct alleged here relevant to your analysis? 2:42PM

A Do they all have to do with future conduct? 2:42PM
Q Yes.
A Then it would not be relevant.
Q Do payments that Philip Morris makes through the master settlement agreement have any bearing on your analysis? 2:42PM
A Payments to -- of what sort?
Q Payments to the various states.
A If they are tied to the same kind of objectionable activity we're talking about here, they might. I would just have to take a look and see what it's all about. 2:42PM
Q Is that relevant to your analysis?
A If we're talking about achieving optimal deterrence, again, if the activity that your -- excuse me. If the activity involved in this lawsuit is the same thing as what is generating the payments, that would be one thing. 2:42PM
If Philip Morris is just paying, for example, for reimbursing healthcare to the states or something else, then it would be irrelevant. 2:43PM
Q Well, let's assume that the payments made through the master settlement agreement are the result of a settlement growing out of the same 2:43PM

allegations that are made in this case; that Philip Morris misled the public. 2:43PM
Assuming that fact, is the amount that Philip Morris is paying through the master settlement agreement relevant to your opinions? 2:43PM
A Well, I mean growing out of the same facts, I'm not sure what you mean by that. I guess all I can tell you is I would have to see it. And the answer, again, is a definite maybe. But I've not seen it, and I don't know. 2:43PM
Q Do you have any intention to look at it?
A If it seems to be of relevance in terms of what we're talking about here, the answer would be yes.
Q Well, if the master settlement agreement 2:44PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

requires Philip Morris to pay $100 billion over 25 years, approximately, and then additional payments in perpetuity, isn't that one way to strip Philip Morris of the benefits that it may have received as a result of misleading the public about the health risks of smoking? 2:44PM

A It could be. Again, all I can tell you is that I would have to see what it's all about.

Q Do you have any intention of doing that?

A I think I just answered this; but yes, if 2:44PM

171

it seems to be of relevance to the issues we are talking about here. 2:44PM

Q When will you determine if it seems to be of relevance?

A After I looked at it. 2:44PM

Q You're going look at it?

A Yes. Yes. If you're telling me -- excuse me.

If you're telling me that this agreement already penalizes Philip Morris for making the sort of statements that allegedly were made in this particular case, if it's exactly the same thing, in other words, as this suit, then that would be one thing. If it's reimbursing states for healthcare or something like that, then that's something else. 2:44PM 2:45PM

Q That's something you would want to find out, right?

A Yes.

Q And you're going to undertake to do that?

A Absolutely. 2:45PM

Q The master settlement agreement provides that payments are made to the various states. Is that a more efficient way of handling punitive damages than making payments to individual plaintiffs? 2:45PM

172

MR. PIUZE: That question is so far -- assumes these are punitive damages, so I'll object to that. Assuming facts not in evidence. 2:45PM

But, please, answer if you can.

MR. STOEVER: I'm not sure that it assumed that the payments made are punitive damages. 2:45PM

BY MR. STOEVER:

Q I'm asking whether payments made to the states to strip away benefits from objectionable conduct is a more efficient way of handling it than making payments of punitive damages to individual plaintiffs. 2:46PM

A I don't see why it would be.

MR. STOEVER: Why don't we take a break. I want to just take a look. I just have a few more things to cover, and I think we can do it quickly. 2:46PM

THE WITNESS: That would be great.

Thank you.

(Discussion off the record.)

BY MR. STOEVER: 3:02PM

Q I want to go back for a moment and talk about the master settlement agreement.

When you look at the master settlement agreement, what analysis will you conduct?

A Well, it would be the things that you 3:03PM

173

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

would expect coming out of the basic model of punitive damages that we see here. The question is, in particular, what is the basis for the payments? I mean are they part of it, or are they related to the sort of objectionable conduct that is the source of this particular suit? 3:03PM 3:03PM

And I have no opinion on that, obviously, because I haven't read the thing. But, once again, there is no -- there is no problem imposing punitive damages in excess of the minimum amount necessary to achieve the optimal deterrence. So anything that relates to payments that might be made on the basis of this objectionable conduct is of interest to me, but... 3:03PM

Q What if the settlement agreement, as many settlement agreements do, doesn't specify -- what if the master settlement agreement doesn't specify what the conduct at issue is; what will you do to determine the conduct that was at issue? 3:04PM

A Well, if it doesn't specify, then there's no reason to assume that it's related to this -- or to the conduct that is at issue in this particular case. 3:04PM

You're asking me to assume that it's just not clear what these payments are being made for? 3:04PM

174

Q Right. 3:04PM

A Well, I guess I just have to tell you I'll decide that when I see it. That strikes me as an unusual settlement agreement that doesn't specify what particular acts that could be alleged against defendants are being settled. But if you say that is, then I have no basis to disagree with you. 3:05PM

Q Would you look at the complaints that were filed by the various attorneys general to determine what facts were being alleged? 3:05PM

A It's not clear why that would matter because if it's not clear that the settlements are being entered into to settle this kind of conduct, it doesn't have any bearing on this sort of objectionable activity. 3:05PM

Q What if the master settlement simply says: This is being entered into to settle the suits listed on attachment A, and there's 46 suits listed on attachment A, and that's all that was said about what is being settled, what would you do to determine whether or not the master settlement agreement is related to the same kind of conduct that is at issue here? 3:05PM

A Is there anything anywhere that is going to tell me what is being settled? What particular things are being settled? 3:06PM

175

Q Well -- 3:06PM

A You said I would have a list of cases, but that doesn't tell me.

Q Frankly, I have not committed the master settlement agreement to memory. 3:06PM

MR. PIUZE: Can I just interrupt for a second. I know we're on a time crunch. Let me do one minute's worth.

The original master settlement agreement called for $346 billion and would have shielded all 3:06PM

http://legacy.library.ucsf.edu/tid/suc07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

companies from punitive damages in perpetuity. The United States of America didn't buy it. The ultimate settlement agreement was for $100 million less in raw money, and punitive damages were not absolved.

There is a document in which one of the CEOs -- I think it's Philip Morris Company -- had the value of -- the present cash value of the punitive damage immunity to be $60 billion. 3:06PM

But this settlement agreement you're asking him to look at, I am telling you right now I know specifically does not include punitive damages, in its second iteration for sure.

/ / / /

176

BY MR. STOEVER:

Q Whether it includes punitive damages or not, if it intends to strip Philip Morris of the kind of conduct being alleged in this case, it would be of interest to you, correct? 3:07PM

A It could be of interest to me, but it's not going to change the basic fact that we talked about, that the key is just that there be some minimal amount, some minimum amount of punitive damages to strip away the expected gains. 3:07PM

If there's more than that, that ultimately results in these situations from payments made to who knows who, there's nothing objectionable in that in terms of this deterrence model.

But it sounds to me from what Mr. Piuze said that it may well be that these are simply compensatory amounts being paid to the states for things other than the kind of thing Ms. Bullock is alleging. 3:07PM

Q How will you determine if they're compensatory amounts being paid to the states? 3:08PM

A I would have to look at the agreement. I don't know what else to tell you than that.

Q If I understand your earlier testimony, you have no way of knowing what amount is necessary 3:08PM

177

to strip Philip Morris of the benefit it may have received from objectionable conduct, correct? 3:08PM

A I have no dollar figure that represents the amount that should be disgorged.

Q And you have no way of estimating a dollar figure, do you? 3:08PM

A As I sit here now, I don't have any facts that would enable me to do that, no.

Q What facts would you need to be able to do that? 3:08PM

A I think we already talked about some of them: Profits; probabilities; length of time that the profits were earned; the extent to which the initial conduct resulted in profits over time.

Q You need to know how many smokers bought cigarettes as a result of being misled? 3:09PM

A Yes.

Q You would need to know what Philip Morris's profits were on those cigarettes?

A Yes. 3:09PM

Q You would need to know how long people were buying cigarettes as a result of being misled?

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

A Correct.
Q What else would you need to know beyond that? 3:09PM

178

A I mentioned the probability of detection. 3:09PM
We talked about that.
Q And just so we're clear, by that you mean what some executive at Philip Morris thought was the probability of detection at the time he or she 3:09PM
entered into -- began the conduct that the jury may find was objectionable?
A Executive or executives, correct.
Q But that's what you mean?
A That's the basic notion we're talking 3:09PM
about, yes.
Q So probability of detection.
What else?
A Would you read back all the things that were proposed? 3:10PM
(The record was read.)
THE WITNESS: To be sure I have given you a complete answer to your question, I would have to sit down and think about that, which I have not been asked to do. It's whatever goes into the expected 3:10PM
damages -- excuse me -- the expected gains that Philip Morris would realize from the objectionable conduct. As I sit here now, I don't think of anything else beyond what you and I have just put on the table. But, again, I would -- to be sure I had 3:11PM

179

given you a complete answer, I would want to think 3:11PM
about that.
BY MR. STOEVER:
Q Let me shift gears a little bit. We've been talking about the master settlement agreement. 3:11PM
Are you aware that Philip Morris has a Web site?
A I have never been to it. I guess I didn't know for sure it did. It doesn't surprise me it does. 3:11PM
Q Do you know that Philip Morris's Web site contains statements about smoking and lung cancer and addiction?
A I haven't been to the site, as I said.
Q I'm asking if you are aware of it. Maybe 3:11PM
you heard about it.
A I wasn't even aware it existed until you just mentioned it.
Q Does the fact that Philip Morris has acknowledged cigarette smoking causes lung cancer 3:11PM
affect your analysis for assessing punitive damages?
A For assessing punitive damages based on past conduct?
Q In this case.
A In this case, no, it doesn't affect it. 3:11PM

180

Q Does the fact that Philip Morris has 3:12PM
admitted cigarette smoking is addictive affect your analysis for assessing punitive damages in this case?
A Other than the fact that the statements 3:12PM
it's now making might be probative of objectionable conduct engaged by Philip Morris earlier, it doesn't

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

go to the question of the amount of punitive damages.

Q So is the answer to my question, no, it doesn't affect your analysis? 3:12PM

A It affects my analysis to the extent that it means that if previous statements were intentionally misleading, this might well be probative of that particular aspect of Philip Morris's conduct. It may make it -- it may make it clearer that it was socially objectionable and, therefore, punitive damages were appropriate. 3:12PM

Q But your analysis isn't to determine whether or not something was socially objectionable? 3:12PM

A That is correct. It's --

Q So for your analysis, does the fact that Philip Morris has admitted that cigarette smoking is addictive affect how -- what you will tell the jury about how to assess punitive damages? 3:13PM

A Only in the sense that it may affect how the jury comes out on whether this was socially objectionable conduct. That's something I'm just going to work with rather than testify about, if that's what you're asking me. 3:13PM

Q So the fact that Philip Morris has admitted that cigarette smoking is addictive doesn't affect your analysis for purposes of this case?

A It would to the extent that I was being asked is this -- is what Philip Morris said in the past the kind of socially objectionable conduct that we ought to deter by punitive damages. 3:13PM

Q Well, do you understand that is something you're being asked to say in this case?

A I think I'm being asked to say it appears that this conduct is the sort of conduct that has an optimal rate of zero. 3:13PM

Q Are you -- assuming the jury finds the facts that Mr. Piuze has asked you to assume, are you going to offer the opinion that that conduct is socially objectionable? 3:14PM

A If the jury has found that this was fraudulent, misleading and what have you?

Q Right.

A I would take that as the kind of thing that ought to be optimally deterred in the way that this paper talks about. 3:14PM

Q But you're not going to do any kind of separate investigation of what is objectionable conduct? 3:14PM

A No. No.

Q So you're going to rely on the jury's determination of whether or not something is objectionable, correct?

A That's a question of fact, and I'm going to take the facts as they come out of this portion of the case. 3:14PM

Q Okay.

MR. PIUZE: And just for completeness, in case he winds up testifying in phase 1, it will be done on a hypothetical, with me asking him to assume that. 3:14PM

THE WITNESS: Right.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

MR. PIUZE: But the point you're looking for is, no, he's not giving any opinion of what Philip Morris did was wrong. That's not what he is --

THE WITNESS: That's correct. But if they did wrong in a socially objectionable sense, what we have been talking about, I mean that's a predicate 3:15PM

183

for the kind of punitive damage analysis we're talking about. 3:15PM

BY MR. STOEVER:

Q Right. It's a predicate, but not the analysis how to assess punitive damages itself, is it? 3:15PM

A That is correct.

Q Okay. Again, does the fact that Philip Morris has admitted that cigarette smoking is addictive affect your analysis? Putting aside the predicate issue, does it affect your analysis of how punitive damages should be assessed in this case? 3:15PM

A Other than the predicate issue?

Q Right.

A Other than it may help to establish the predicate. 3:15PM

Q Which the jury is going to do?

A Which the jury is going to do. What you said is correct.

Q Are you aware that Philip Morris has initiated an anti-smoking program for young people? 3:15PM

A I was not aware of that.

Q Have you seen any of the Philip Morris advertisements on television encouraging young people not to smoke? 3:16PM

184

A I have not, as far as I know. 3:16PM

Q Are you -- assume with me that Philip Morris has initiated a program to discourage smoking among young people. Does that fact -- is that fact at all relevant to your analysis of how punitive damages should be assessed in this case? 3:16PM

A Punitive damages for past acts?

Q Yes.

A It does not affect that analysis.

Q Does the extent to which the federal or state government is scrutinizing Philip Morris's activities currently affect your analysis for how punitive damages should be assessed in this case? 3:16PM

A No.

Q Have you done any assessment of whether or not Philip Morris is heavily -- is regulated by either the state or federal governments? 3:16PM

A No.

Q Does -- are you aware of any Philip Morris's current research and development projects? 3:17PM

A No.

Q Assume with me that Philip Morris is conducting research and development to try to develop a safer cigarette. Does that fact have any bearing on your analysis of how punitive damages 3:17PM

185

should be assessed in this case? 3:17PM

A No.

Q Assuming, since you haven't seen the Web

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

site, assuming that Philip Morris has admitted that cigarette smoking causes lung cancer and smoking is addictive, how likely do you think it is that Philip Morris can, again, engage in the sort of conduct that Mr. Piuze asked you to assume when he called you back in January? 3:17PM

A How likely is it? Less likely than it was before, but I don't have a number. 3:17PM

Q Is it -- you say it's less likely than it was before. How much less likely?

A I don't know.

Q Since Philip Morris has admitted that cigarette smoking causes lung cancer, do you think it's likely that Philip Morris is going to dispute that fact some day? 3:18PM

A Suppose it turns out there are safer cigarettes and that, therefore, this is not as big a problem? They might. 3:18PM

Q But you have no way of knowing one way or the other?

A I have no way of knowing one way or the another. 3:18PM

Q And you haven't done any kind of independent inquiry into this? 3:18PM

A No.

Q And whether or not Philip Morris can once again deny -- or let me rephrase that. 3:18PM

The likelihood that Philip Morris could deny cigarette smoking causes lung cancer, does that have any bearing on your analysis for this case?

A Not in the analysis of punitive damage for past acts, no. 3:18PM

Q We've talked a little bit about smoking.

You said you quit about 20 years ago?

A Twenty to twenty-five years ago, I would say, yes, sir.

Q How did you quit? 3:19PM

A Just gradually tapered off to zero.

Q While you were smoking, did you buy any cigarettes as a result of being deceived by the tobacco industry?

A How would I know I was deceived? 3:19PM

Q Well, given what you know today, do you think you were deceived by the tobacco industry?

A It's so long ago, I have no way of reconciling what I know today with what I was hearing back then. I'm just unable to answer that question. 3:19PM

3:19PM

Q Other than -- well, withdraw that.

You mentioned that your wife has been diagnosed with cancer. Is that related in any way to smoking? 3:20PM

A No, not at all.

Q Have any members of your immediate family been diagnosed with any disease related to cigarette smoking?

A No, sir, not that I'm aware of. 3:20PM

Wait a minute. My grandfather. My grandfather had pneumonia, died of pneumonia, and he was a smoker. And apparently that exacerbated his condition.

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Q Do you believe -- how long ago was that, I'm sorry? 3:20PM
A He died in 1979.
Q And when he died, were you aware that cigarette smoking was -- at least exacerbated the condition? 3:20PM
A He had been told to stop smoking. He was 86 and said, "The heck with it."
Q Do you believe that cigarette smoking causes lung cancer?
A Everything I -- everything I read suggests 3:20PM

that it does, yes. 3:20PM
Q So do you believe that?
A I have no reason not to. It's not something I have ever independently investigated, but if you ask me which side of the issue I would 3:20PM guess is more likely true, I would say that it does.
Q And how long -- for how long would you say you have thought that it's more likely that smoking causes lung cancer?
A I really have no idea. 3:21PM
Q Is it more than 20 years?
A It could be.
Q Do you believe that cigarette smoking is addictive?
A I have no opinion. It's a pharmacological 3:21PM question.
Q Do you have a belief one way or another?
A No.
Q I want to show you the brief filed in TXO Production Corp. This is one of the documents you 3:21PM have given us today.
A Right.
Q How does that brief relate to your opinion in this case?
A Well, as I remember, the brief is 3:22PM

essentially about this model of -- this economic 3:22PM model of optimal deterrence of certain kinds of socially undesirable conduct. It's, therefore, an application of the kinds of things that are talked about in this article to the specifics of the TXO 3:22PM case.
Q So it's -- is the brief derivative of the article?
A I'm not sure what you mean by "derivative." It addresses some of the points -- 3:22PM addresses some of the points that the article addresses, and it cites the article. So I think all I can say is that I think that what the article talked about here in the abstract, the brief is talking about with specific reference to the facts 3:22PM of the TXO case.
Q How did the TXO case come down from your standpoint? Did the court support the position taken by the party that you were writing on behalf of? 3:23PM
A Well, they found for TXO, as I recall, or -- excuse me -- for Alliance.
Q Were you writing as amicus for Alliance?
A I have to go back and remember. I have forgotten the party's name. 3:23PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

Yeah, we were writing for Alliance. 3:23PM
Q Let me hand you --
A This was almost ten years ago, so...
Q Let me hand you the brief from BMW of North America V Gore, that was entitled "Brief of Law and Economic Scholars," and has a list of names as amicus -- 3:23PM
A Right.
Q -- and ask you, how does that document support the opinions you intend to offer in this case? 3:23PM
A Well, I would give the same answer as for the TXO case. In general, the model being adopted here is one that is consistent with -- I think to some extent, informed by the article we have been talking about. There may be issues in these two cases that don't relate to anything we're talking about here, so I don't want to suggest that everything in these two briefs comes out of this particular article, but I think in their general thrust, the two briefs are consistent with what is in the article. 3:24PM 3:24PM
Q The brief from BMW that I just handed you, did you have a role in drafting that?
A I don't think I did. My name isn't on it. 3:24PM

Q How did you become aware of the fact that that brief was being filed in the TXO case? 3:24PM
A In the TXO case?
Q I'm sorry. In the BMW case. Pardon me. My mistake. 3:24PM
A Here is my name. It's listed up here, but I'm not listed in the -- as I recall, I was asked whether I would read and comment on it, and if I agreed with the ultimate version, sign on to the brief in this particular case. 3:25PM
Q And how did the court come down in that case? Did they come down for the party you were writing in support of?
A They came down for Mr. Gore, as I recall, which is the party we were bringing in support of. 3:25PM
Q Let me hand you the last brief that you provided us, which is a brief amicus curiae of legal historian filed in the BMW case, and ask you how that document supports the opinions you intend to offer in this case. 3:25PM
A I don't think I was involved in this one. I wasn't involved in this. So particularly to the extent that it's a historical argument -- I'm just looking at the arguments here -- this wouldn't seem to have very much to do with the -- with what is in 3:26PM

the California Law Review piece. 3:26PM
Q If it doesn't have much to do with what is in the California Law Review piece, why was that produced today as part of your materials?
A Because it was given to me to read, and I read it. I was asked to read it. 3:26PM
Q Given to you by Mr. Piuze?
A By Paula Lawlor.
Q From Mr. Piuze's office?
A From Mr. Piuze's office. 3:26PM

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: https://www.industrydocuments.ucsf.edu/docs/hxhl0001

MR. STOEVER: I think I don't -- let's see. What this is.

I don't have any further questions for you right now, Mr. McChesney. Thank you.

I do not want to close the deposition. I think it sounds like Mr. McChesney has additional work to do, specifically with respect to the MSA and with respect to reviewing the record at trial in this case. And I'm going to reserve Philip Morris's right to redepose Mr. McChesney once he has completed that work so we can explore further with him the bases for his opinions. 3:26PM 3:27PM

MR. PIUZE: I don't think Philip Morris has any right for further deposition. This man has to go to the airport. We'll discuss it at a different day. I would say this deposition is over. 3:27PM 3:27PM

I will stipulate that the court reporter is relieved of her obligations under the Code of Civil Procedure in California as they exist if she will send the original of this deposition directly to the witness at the place he has told her about; if the witness is allowed to sign under penalty of perjury at the time and place of his choosing. And I will agree to notify Philip Morris of any changes, additions or corrections to the deposition within 30 days of the witness' receipt of the deposition. Okay? 3:27PM 3:27PM 3:27PM

MR. STOEVER: Or I mean what if 30 days --

MR. PIUZE: He ain't testifying any time in the near future, or 48 hours before he testifies, whichever is first. 3:28PM

MR. STOEVER: So stipulated.

THE WITNESS: Thank you, sir.

(TIME NOTED: 3:28 p.m.)

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on _____, 20_____, at _____, _____.

_____

SIGNATURE OF THE WITNESS

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

STATE OF CALIFORNIA) ss:
COUNTY OF LOS ANGELES)

I, LANA L. LOPER, RPR, CRR, CSR No. 9667, CCR No. 690, do hereby certify:

That the foregoing deposition of FRED S. McCHESNEY, Ph.D. was taken before me at the time and place therein set forth, at which time the witness was placed under oath and was sworn by me to tell the truth, the whole truth, and nothing but the truth;

That the testimony of the witness and all objections made by counsel at the time of the examination were recorded stenographically by me, and were thereafter transcribed under my direction and supervision, and that the foregoing pages contain a full, true and accurate record of all proceedings and testimony to the best of my skill and ability.

I further certify that I am neither related to counsel for any party to said action, nor am I related to any party to said action, nor am I in any way interested in the outcome thereof.

IN WITNESS WHEREOF, I have subscribed my name this 16th day of May, 2002.

_____

LANA L. LOPER, RPR, CRR, CSR 9667, CCR 690

I N D E X
VOLUME I

TUESDAY, MAY 14, 2002

WITNESS EXAMINATION

http://legacy.library.ucsf.edu/tid/suq07a00/pdf Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001

FRED S. McCHESNEY, Ph.D.

(By Mr. Stoever) 3

DEPOSITION EXHIBITS
FRED S. McCHESNEY, Ph.D.

NUMBER	DESCRIPTION	IDENTIFIED
1	Curriculum Vitae	4
2	Notice of Expert Witness Depositions and Notice to Produce Documents for Inspection and Copying	37
3	Plaintiff's Expert Witness List	46
4	Excerpt of Plaintiff's Expert Witness List with demarcated markings and initials	47
5	California Law Review article An Ordinary Economic Rationale for Extraordinary Legal Sanctions	65

http://legacy.library.ucsf.edu/tid/suq07a00/pdf
Source: http://www.industrydocuments.ucsf.edu/docs/hxhl0001